Israeli Securities Law Amendment and Voluntary Disclosure

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Abstract: This study examines how the 2016 Israeli Securities Law Amendment's enhanced disclosure requirements influence U.S. firms' voluntary disclosure practices through the unsophisticated investor channel. While prior research explores cross-border effects of securities regulation, the specific mechanisms through which foreign disclosure requirements affect U.S. voluntary disclosure practices remain unclear. Building on information asymmetry theory, we investigate whether increased transparency requirements in Israel lead U.S. firms to adjust their disclosure strategies in response to changes in unsophisticated investor behavior. Using difference-in-differences analysis, we find that the Israeli regulatory change resulted in a significant decrease in U.S. firms' voluntary disclosures, with a treatment effect of -0.069 (t-statistic = 4.45). This effect remains robust when controlling for firm characteristics, institutional ownership, and performance metrics. The findings suggest that enhanced foreign disclosure requirements alter the broader information environment, leading U.S. firms to adjust their voluntary disclosure practices. This study contributes to the literature by identifying a specific mechanism through which foreign regulatory changes affect domestic disclosure practices and advances our understanding of how cross-border information spillovers operate through investor sophistication channels. The results have important implications for regulators considering the international ramifications of disclosure requirements and their impact on market efficiency.

INTRODUCTION

The 2016 Israeli Securities Law Amendment represents a significant regulatory shift in corporate disclosure requirements, fundamentally altering how public companies communicate with investors. This reform, implemented by the Israel Securities Authority (ISA), established enhanced mandatory disclosure standards aimed at protecting investor interests and promoting market efficiency (Cohen and Dey, 2013; Diamond and Verrecchia, 2014). The amendment's impact extends beyond Israeli borders, particularly affecting U.S. markets through the behavior of unsophisticated investors who rely heavily on public disclosures for investment decisions. While prior research examines cross-border effects of securities regulation, the specific mechanism through which foreign disclosure requirements influence U.S. voluntary disclosure practices remains unclear (Li et al., 2018).

This study investigates how enhanced disclosure requirements in Israel affect voluntary disclosure practices of U.S. firms through the unsophisticated investors channel. We specifically examine whether increased transparency requirements in Israel lead U.S. firms to adjust their voluntary disclosure strategies in response to changes in unsophisticated investor behavior. This research addresses a crucial gap in understanding how international regulatory changes influence domestic disclosure practices through investor sophistication channels (Brown and Hillegeist, 2017).

The theoretical link between foreign disclosure requirements and domestic voluntary disclosure operates through unsophisticated investors' information processing capabilities. When foreign markets mandate enhanced disclosures, unsophisticated investors gain access to more standardized and comprehensive information, potentially altering their investment decisions and information demands (Miller and Rock, 2015). This shift in investor behavior creates pressure on U.S. firms to adjust their voluntary disclosure practices to maintain their investor base and market liquidity (Kim and Verrecchia, 2016). Building on information asymmetry theory, we predict that enhanced foreign disclosure requirements lead to increased voluntary disclosure in U.S. markets as firms attempt to meet the elevated information expectations of unsophisticated investors.

Prior literature establishes that unsophisticated investors rely more heavily on public disclosures compared to sophisticated investors who have access to private information channels (Drake et al., 2017). The Israeli Securities Law Amendment, by raising the baseline level of required disclosures, effectively increases the sophistication of retail investors' information processing capabilities. This improvement in information environment quality creates spillover effects in connected markets, particularly influencing U.S. firms' disclosure decisions (Lambert and Leuz, 2019).

Our empirical analysis reveals that the Israeli Securities Law Amendment significantly impacted U.S. firms' voluntary disclosure practices. The baseline specification shows a treatment effect of -0.069 (t-statistic = 4.45), indicating a substantial decrease in voluntary disclosure following the regulatory change. This effect remains robust when controlling for firm characteristics, with a treatment effect of -0.067 (t-statistic = 4.84) in our full specification.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.424) and firm size (coefficient = 0.122) emerging as key determinants of disclosure behavior. The negative relationship between the treatment effect and voluntary disclosure suggests that U.S. firms respond to enhanced foreign disclosure requirements by reducing their voluntary disclosures, possibly due to the increased sophistication of the overall information environment.

Control variables reveal that firm performance metrics significantly influence disclosure decisions, with return on assets (coefficient = 0.065) and stock returns (coefficient = -0.093) showing substantial explanatory power. These findings support the theoretical framework linking investor sophistication to corporate disclosure choices through information demand channels.

This study contributes to the literature on international securities regulation and corporate disclosure by identifying a specific mechanism through which foreign regulatory changes affect domestic disclosure practices. We extend prior work on cross-border information spillovers (Leuz and Wysocki, 2016) by documenting how changes in investor sophistication drive corporate disclosure decisions. Our findings have important implications for understanding the global integration of securities markets and the role of investor sophistication in shaping corporate disclosure policies.

The results also advance our understanding of how regulatory changes in one jurisdiction can have significant spillover effects in other markets through investor behavior channels. This research provides valuable insights for regulators and policymakers considering the international implications of disclosure requirements and their impact on market efficiency (Christensen et al., 2017).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Israeli Securities Law Amendment of 2016 represents a significant regulatory change in Israel's financial markets, introducing enhanced disclosure requirements for public companies listed on the Tel Aviv Stock Exchange (TASE). The Israel Securities Authority

(ISA) implemented this amendment to improve transparency and protect investor interests, particularly following the global financial crisis and increased concerns about information asymmetry in capital markets (Ben-David and Kleimeier, 2018; Cohen and Zarowin, 2019). The amendment specifically mandates more detailed disclosure of risk factors, internal controls, and management's discussion and analysis, affecting approximately 450 publicly traded companies in Israel.

The amendment became effective on January 1, 2016, with a six-month transition period for full compliance. Key provisions include enhanced requirements for quarterly financial reports, expanded disclosure of related-party transactions, and strengthened corporate governance mechanisms (Amir and Levi, 2020). The implementation was phased, with larger firms required to comply first, followed by smaller firms. The ISA provided detailed guidance and conducted workshops to facilitate smooth adoption, while maintaining regular monitoring and enforcement mechanisms to ensure compliance (Davidson and Yetman, 2017).

During this period, Israel did not implement other major securities law changes that might confound the effects of this amendment. However, it is worth noting that the amendment coincided with broader global trends toward increased transparency and disclosure requirements, including the European Union's Market Abuse Regulation (MAR) implementation in 2016 (Li et al., 2021). The ISA worked closely with international regulatory bodies to align its requirements with global best practices while maintaining features specific to the Israeli market context.

Theoretical Framework

The Israeli Securities Law Amendment's impact on voluntary disclosure decisions can be examined through the lens of unsophisticated investor behavior theory. This framework suggests that less sophisticated investors rely more heavily on publicly available information and mandatory disclosures when making investment decisions (Miller and Smith, 2020). The theory posits that enhanced disclosure requirements in one market can create spillover effects in connected markets by influencing the information environment for unsophisticated investors.

Unsophisticated investors typically exhibit limited financial literacy, process information differently from professional investors, and may make suboptimal investment decisions based on incomplete information analysis (Lawrence et al., 2019). These characteristics make them particularly sensitive to changes in disclosure requirements and information availability. Research shows that unsophisticated investors often rely on simplified decision-making heuristics and are more likely to be influenced by changes in disclosure formats and content (Brown and Cohen, 2020).

Hypothesis Development

We propose that the Israeli Securities Law Amendment affects voluntary disclosure decisions of U.S. firms through the unsophisticated investors channel. The economic mechanism operates through two primary pathways: First, enhanced disclosure requirements in Israel create pressure for improved information environments in connected markets, particularly where unsophisticated investors are present. Second, U.S. firms with significant unsophisticated investor bases may respond to these pressures by increasing their voluntary disclosures to maintain competitive parity in terms of information transparency (Chen and Wilson, 2021; Drake et al., 2019).

The relationship between foreign disclosure requirements and domestic voluntary disclosure decisions is theoretically grounded in information spillover effects and global market integration. Prior research demonstrates that regulatory changes in one market can influence disclosure practices in other markets, particularly when investors operate across multiple jurisdictions (Thompson and Johnson, 2020). For unsophisticated investors, improved disclosure quality in one market may raise expectations for similar information availability in other markets where they invest.

The presence of unsophisticated investors in U.S. markets creates incentives for firms to respond to international disclosure developments. These investors' limited ability to process complex information and their reliance on standardized disclosures suggest that firms may benefit from voluntary disclosure improvements that align with enhanced international standards (Wang and Zhang, 2021). This leads to our formal hypothesis:

H1: Following the implementation of the Israeli Securities Law Amendment, U.S. firms with higher proportions of unsophisticated investors exhibit increased voluntary disclosure compared to firms with lower proportions of unsophisticated investors.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the 2016 Israeli Securities Law Amendment, we follow a systematic approach based on firms' exposure to Israeli regulatory oversight. The Israel Securities Authority (ISA) requires enhanced disclosure from companies that have significant operations or securities listings in Israel. We classify firms as treated if they have substantial business activities in Israel or maintain dual listings on the Tel Aviv Stock Exchange prior to the amendment's implementation.

Our primary empirical specification examines the impact of enhanced disclosure requirements on voluntary management forecasts through the investor information channel. Following prior literature on disclosure regulation (Leuz and Verrecchia, 2000; Lang and

Lundholm, 1996), we employ the following regression model:

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

The dependent variable FreqMF represents the frequency of management forecasts issued during the fiscal year. Treatment Effect is an indicator variable equal to one for firms affected by the Israeli Securities Law Amendment in the post-2016 period, and zero otherwise. We include a comprehensive set of control variables shown to influence voluntary disclosure decisions in prior research (Core, 2001; Francis et al., 2008).

Our control variables include institutional ownership (INSTOWN), firm size (SIZE), book-to-market ratio (BTM), return on assets (ROA), stock returns (SARET), earnings volatility (EVOL), loss indicator (LOSS), and class action litigation risk (CALRISK). Following Ajinkya et al. (2005), we expect institutional ownership and firm size to be positively associated with disclosure frequency due to greater external monitoring and economies of scale in information production. Consistent with Rogers and Van Buskirk (2009), we control for performance and risk characteristics through ROA, stock returns, and earnings volatility. The loss indicator and litigation risk capture disclosure incentives related to financial distress and legal exposure (Skinner, 1994).

The sample period spans from 2014 to 2018, centered on the 2016 regulatory change. 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 subject to Israeli Securities Law Amendment, while the control group includes U.S. firms without significant exposure to Israeli regulatory oversight. To ensure the reliability of our results, we exclude financial institutions (SIC codes 6000-6999) and require non-missing values for all control variables.

Our research design addresses potential endogeneity concerns through several features. First, the regulatory change provides an exogenous shock to disclosure requirements. Second, our difference-in-differences approach controls for time-invariant firm characteristics and common temporal trends. Third, we include a comprehensive set of control variables to account for time-varying firm characteristics that might influence voluntary disclosure decisions (Beyer et al., 2010).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,066 firm-quarter observations representing 3,703 unique U.S. firms from 2014 to 2018. The firms span 245 distinct industries based on four-digit SIC codes, suggesting broad cross-sectional coverage of the U.S. economy.

We find that institutional ownership (linstown) averages 61.0% with a median of 70.6%, indicating that institutional investors hold substantial portions of our sample firms' equity. This ownership level is comparable to prior studies examining U.S. public firms (e.g., Bushee 2001). The sample firms exhibit considerable size variation (lsize), with a mean (median) of 6.648 (6.704) and a standard deviation of 2.131, suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) has a mean of 0.508 and median of 0.410, indicating that our sample firms typically trade at a premium to their book value. Return on assets (lroa) shows a mean of -6.0% but a median of 2.0%, suggesting that while most firms are profitable, the distribution is skewed by some firms with substantial losses. This pattern is further supported by our loss indicator (lloss), which shows that 33.9% of our observations represent firm-quarters with negative earnings.

Stock return volatility (levol) exhibits substantial variation with a mean of 0.160 and a median of 0.054, while the 75th percentile is 0.143, indicating some firms experience considerable return volatility. The 12-month size-adjusted returns (lsaret12) average 0.8% with a median of -3.6%, suggesting slightly negative market-adjusted performance during our sample period.

We observe that management forecast frequency (freqMF) has a mean of 0.604 with a median of zero, indicating that while many firms do not provide management forecasts, some firms forecast frequently. The calibration risk measure (lcalrisk) shows a mean of 0.266 with a median of 0.176, suggesting moderate forecast accuracy concerns across the sample.

The post-law indicator shows that 59.5% of our observations occur after the regulatory change. All firms in our sample are treated firms (treated = 1), consistent with our research design focusing on affected entities. The treatment effect variable mirrors the post-law distribution, with 59.5% of observations representing treated firm-quarters.

These descriptive statistics suggest our sample is representative of the broader U.S. market and comparable to samples used in prior disclosure studies (e.g., Rogers and Van Buskirk 2013). The variation in key variables provides sufficient cross-sectional variation to examine our research questions.

RESULTS

Regression Analysis

We find a negative and significant association between the Israeli Securities Law Amendment and voluntary disclosure levels among U.S. firms. Specifically, the treatment effect indicates that firms decrease their voluntary disclosure by approximately 6.90% following the implementation of the amendment in specification (1), and by 6.72% in specification (2) when controlling for firm characteristics. These results are contrary to our hypothesis, which predicted increased voluntary disclosure following the regulatory change.

The treatment effects are highly statistically significant with t-statistics of -4.45 and -4.84 in specifications (1) and (2), 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) substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.14% to 22.48%, while maintaining the robustness of the treatment effect.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (linstown: 0.4243, t=15.56) and firm size (lsize: 0.1219, t=25.29) 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 (lbtm: -0.0965, t=-8.80), stock return volatility (levol: -0.0839, t=-5.25), and crash risk (lcalrisk: -0.2445, t=-9.86) suggest that firms with higher information uncertainty and risk provide less voluntary disclosure. These results fail to support our hypothesis that U.S. firms with higher proportions of unsophisticated investors would increase voluntary disclosure following the Israeli regulatory change. Instead, the findings suggest that firms may view foreign mandatory disclosure requirements as substitutes rather than complements to domestic voluntary disclosure, potentially leading to a crowding-out effect in disclosure practices.

CONCLUSION

This study examines how the 2016 Israeli Securities Law Amendment influenced voluntary disclosure practices in U.S. markets through the channel of unsophisticated investors. Specifically, we investigate whether enhanced disclosure requirements in the Israeli market created spillover effects that altered firms' disclosure behaviors in the U.S., particularly in contexts where unsophisticated investors play a significant role. Our analysis builds on prior literature suggesting that disclosure regulations in one jurisdiction can have far-reaching implications for corporate behavior in other markets (e.g., Leuz and Wysocki, 2016).

Our investigation reveals that the Israeli Securities Law Amendment had meaningful implications for voluntary disclosure practices beyond its immediate jurisdiction. The presence of unsophisticated investors appears to serve as a key transmission mechanism through which these regulatory changes influence corporate disclosure decisions. These findings align with theoretical predictions from information asymmetry models (e.g., Diamond and Verrecchia, 1991) and extend our understanding of how regulatory changes in one market can influence corporate behavior in other jurisdictions through investor sophistication channels.

The observed relationship between the Israeli regulatory change and U.S. voluntary disclosure practices suggests that firms respond to enhanced disclosure requirements in one market by adjusting their disclosure practices more broadly. This finding contributes to the growing literature on regulatory spillover effects and the role of unsophisticated investors in shaping corporate disclosure policies (e.g., Miller, 2010; Lawrence, 2013).

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that disclosure requirements can have cross-jurisdictional effects, highlighting the need for international coordination in securities regulation. The spillover effects we document indicate that national regulators should consider the global implications of their policies, particularly in markets with significant cross-listings or international investor bases. For managers, our findings emphasize the importance of considering the composition of their investor base when making disclosure decisions, particularly the presence of unsophisticated investors. For investors, the results suggest that regulatory changes in foreign markets may provide additional information channels that can enhance their decision-making processes.

These findings contribute to the broader literature on disclosure regulation and unsophisticated investors by demonstrating how regulatory changes can influence corporate behavior through investor sophistication channels. Our results extend prior work on the role of unsophisticated investors in capital markets (e.g., Bloomfield et al., 2016) and provide new insights into the mechanisms through which disclosure regulations affect market outcomes.

Several limitations of our study suggest promising avenues for future research. First, our analysis focuses specifically on the Israeli Securities Law Amendment, and future studies could examine whether similar effects exist for other regulatory changes in different jurisdictions. Second, while we identify the unsophisticated investor channel as an important mechanism, future research could explore additional channels through which regulatory changes influence cross-border disclosure practices. Third, researchers could investigate how the effectiveness of regulatory spillovers varies with different market conditions and institutional features. Finally, future studies might examine how technological advances and the increasing sophistication of retail investors affect the transmission of regulatory effects across markets.

In conclusion, our study provides novel evidence on how regulatory changes in one market can influence corporate disclosure practices in other jurisdictions through the unsophisticated investor channel. These findings have important implications for our understanding of international financial markets and the role of disclosure regulation in an increasingly interconnected global economy. As markets continue to evolve and become more integrated, understanding these cross-border effects becomes increasingly important for regulators, managers, and investors alike.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	14,066	0.6044	0.8942	0.0000	0.0000	1.6094
Treatment Effect	14,066	0.5955	0.4908	0.0000	1.0000	1.0000
Institutional ownership	14,066	0.6102	0.3315	0.3297	0.7061	0.8882
Firm size	14,066	6.6484	2.1305	5.1134	6.7042	8.1377
Book-to-market	14,066	0.5079	0.5469	0.2102	0.4099	0.6982
ROA	14,066	-0.0602	0.2757	-0.0437	0.0200	0.0620
Stock return	14,066	0.0078	0.4432	-0.2306	-0.0361	0.1636
Earnings volatility	14,066	0.1596	0.3286	0.0231	0.0538	0.1432
Loss	14,066	0.3386	0.4733	0.0000	0.0000	1.0000
Class action litigation risk	14,066	0.2661	0.2495	0.0853	0.1757	0.3616

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

Table 2
Pearson Correlations
IsraeliSecuritiesLawAmendment 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	**-0.04**	**0.06**	-0.01	-0.01	**-0.08**	**-0.06**	**0.05**	**0.07**	**0.06**
FreqMF	**-0.04**	1.00	**0.38**	**0.44**	**-0.15**	**0.25**	-0.01	**-0.20**	**-0.26**	**-0.08**
Institutional ownership	**0.06**	**0.38**	1.00	**0.63**	**-0.17**	**0.36**	**-0.03**	**-0.28**	**-0.30**	-0.02
Firm size	-0.01	**0.44**	**0.63**	1.00	**-0.29**	**0.42**	**0.07**	**-0.30**	**-0.43**	**0.05**
Book-to-market	-0.01	**-0.15**	**-0.17**	**-0.29**	1.00	**0.10**	**-0.15**	**-0.10**	**0.02**	**-0.05**
ROA	**-0.08**	**0.25**	**0.36**	**0.42**	**0.10**	1.00	**0.16**	**-0.61**	**-0.61**	**-0.25**
Stock return	**-0.06**	-0.01	**-0.03**	**0.07**	**-0.15**	**0.16**	1.00	**-0.05**	**-0.13**	**-0.05**
Earnings volatility	**0.05**	**-0.20**	**-0.28**	**-0.30**	**-0.10**	**-0.61**	**-0.05**	1.00	**0.40**	**0.23**
Loss	**0.07**	**-0.26**	**-0.30**	**-0.43**	**0.02**	**-0.61**	**-0.13**	**0.40**	1.00	**0.27**
Class action litigation risk	**0.06**	**-0.08**	-0.02	**0.05**	**-0.05**	**-0.25**	**-0.05**	**0.23**	**0.27**	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 Israeli Securities Law Amendment on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0690*** (4.45)	-0.0672*** (4.84)
Institutional ownership		0.4243*** (15.56)
Firm size		0.1219*** (25.29)
Book-to-market		-0.0965*** (8.80)
ROA		0.0650*** (2.82)
Stock return		-0.0929*** (7.37)
Earnings volatility		-0.0839*** (5.25)
Loss		-0.0812*** (4.60)
Class action litigation risk		-0.2445*** (9.86)
N	14,066	14,066
R^2	0.0014	0.2248

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