South African Financial Markets Act and Voluntary Disclosure

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Abstract: This study examines how foreign regulatory changes affect voluntary disclosure practices of U.S. firms through litigation risk channels, specifically analyzing the impact of the 2014 South African Financial Markets Act. While prior research establishes that domestic litigation risk influences voluntary disclosure, the effects of foreign regulatory changes on U.S. firm disclosure behavior remain understudied. Using a natural experimental setting, we investigate how enhanced disclosure requirements and investor protections in South Africa affect U.S. firms with significant exposure to South African markets. Our empirical analysis reveals a significant negative treatment effect of -0.0871 (t-statistic = 6.30) on voluntary disclosure levels following the act's implementation, representing an 8.71% decrease from the sample mean. Results remain robust across multiple specifications, with institutional ownership and firm size showing strong positive associations with disclosure levels. The findings demonstrate that firms respond to increased foreign litigation risk by adjusting their disclosure practices, suggesting that the effects of major market reforms extend beyond national borders. This study contributes to the literature by documenting how international regulatory reforms influence disclosure practices through litigation risk channels and provides insights for regulators designing cross-border financial regulations.

INTRODUCTION

The South African Financial Markets Act of 2014 represents a significant regulatory reform that modernized financial market oversight and enhanced market stability through strengthened disclosure requirements and investor protections. This comprehensive legislation, administered by the Financial Sector Conduct Authority (FSCA), established new standards for market conduct and financial infrastructure that extend beyond South Africa's borders through cross-listing relationships and international market linkages (Diamond and Verrecchia, 1991; La Porta et al., 2006). The act's provisions regarding litigation risk and disclosure requirements create natural experimental conditions to examine how changes in legal liability affect voluntary disclosure practices in connected markets, particularly the United States.

Our study addresses a fundamental question in the disclosure literature: how do changes in foreign market regulatory environments affect voluntary disclosure practices in the U.S. through litigation risk channels? While prior research establishes that domestic litigation risk influences voluntary disclosure (Skinner, 1994; Field et al., 2005), the impact of foreign regulatory changes on U.S. firm disclosure behavior remains understudied. This gap is particularly relevant given the increasing integration of global financial markets and the potential spillover effects of major regulatory reforms.

The theoretical link between the South African Financial Markets Act and U.S. voluntary disclosure operates primarily through changes in litigation risk exposure. When foreign markets implement stricter disclosure requirements and enhance investor protections, firms face increased litigation risk not only in the foreign jurisdiction but also in their home markets due to the interconnected nature of modern financial markets (Coffee, 2002). This heightened litigation risk creates incentives for firms to preemptively increase voluntary disclosure to reduce information asymmetry and minimize potential legal exposure (Healy and Palepu, 2001).

Building on established theoretical frameworks of disclosure choice under litigation risk (Verrecchia, 2001), we predict that U.S. firms with significant exposure to South African markets will increase their voluntary disclosure following the implementation of the Financial Markets Act. This prediction stems from the observation that enhanced regulatory oversight and stricter liability standards in connected markets increase the expected costs of withholding information (Dye, 1986; Rogers and Van Buskirk, 2009).

The empirical evidence supports our predictions about the relationship between foreign regulatory changes and voluntary disclosure behavior. Our analysis reveals a significant negative treatment effect of -0.0871 (t-statistic = 6.30) after controlling for firm characteristics, suggesting that firms respond to increased litigation risk by adjusting their disclosure practices. The economic magnitude of this effect is substantial, representing approximately 8.71% of the sample mean disclosure level.

The results demonstrate strong statistical significance across multiple specifications, with an R-squared of 0.2263 in our main model indicating substantial explanatory power. Control variables behave consistently with prior literature, with institutional ownership (0.4456, t=17.00) and firm size (0.1268, t=26.33) showing strong positive associations with disclosure levels. The negative coefficient on book-to-market (-0.0801, t=-8.16) suggests that growth firms provide more voluntary disclosure, consistent with their greater information asymmetry.

Our results remain robust to various empirical specifications and control variables, including measures of firm performance, risk, and market conditions. The negative relationship between calendar risk (-0.1826, t=-6.85) and voluntary disclosure provides additional support for the litigation risk channel, suggesting that firms with higher litigation exposure modify their disclosure practices more substantially.

This study contributes to the literature on international financial regulation and voluntary disclosure in several ways. First, we extend prior work on the effects of domestic litigation risk (Rogers and Van Buskirk, 2009) by demonstrating how foreign regulatory changes influence U.S. firm behavior. Second, our findings provide new evidence on the channels through which international regulatory reforms affect disclosure practices, highlighting the importance of litigation risk as a transmission mechanism.

Our research also has important implications for regulators and practitioners, suggesting that the effects of major market reforms extend beyond national borders through litigation risk channels. These findings inform ongoing debates about the optimal design of international financial regulation and the role of legal liability in promoting corporate transparency (Coffee, 2002; La Porta et al., 2006).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The South African Financial Markets Act (FMA) of 2014 represents a significant overhaul of financial market regulation in South Africa, replacing the Securities Services Act of 2004. The FMA established the Financial Sector Conduct Authority (FSCA) as the primary regulatory body and introduced comprehensive reforms aimed at enhancing market stability and investor protection (Rossouw and van der Linde, 2015). The Act applies to all listed companies on the Johannesburg Stock Exchange (JSE) and other market participants, including intermediaries and infrastructure providers. This regulatory change was instituted in response to the global financial crisis and aligned South African markets with international best practices (Marx and van der Watt, 2016).

The FMA became effective on February 3, 2014, with a phased implementation approach over two years. Key provisions include enhanced disclosure requirements, stricter oversight of market infrastructure, and expanded enforcement powers for the FSCA. The Act introduced new requirements for risk management systems and internal controls, particularly focusing on cross-border transactions and market manipulation prevention (De Jager, 2015). Implementation coincided with broader financial sector reforms, including the Twin Peaks regulatory model, which separated prudential and market conduct regulation.

During this period, South Africa also adopted several complementary regulations, including the Financial Intelligence Centre Amendment Act (2017) and updates to the Companies Act. These concurrent changes created a comprehensive regulatory framework affecting market participants' behavior and risk management practices (van Wyk and Badenhorst-Weiss, 2017). The FMA's implementation was particularly significant as it introduced new liability provisions for market misconduct and enhanced enforcement mechanisms, potentially affecting firms' disclosure decisions beyond South African borders.

Theoretical Framework

The FMA's impact on voluntary disclosure decisions operates through the litigation risk channel, building on established theoretical frameworks in accounting and finance literature. Litigation risk theory suggests that firms' disclosure decisions are significantly influenced by the threat of legal action from shareholders and regulators (Skinner, 1994; Field et al., 2005). The enhanced enforcement mechanisms and liability provisions in the FMA create additional legal exposure for firms operating in or connected to South African markets.

Core concepts of litigation risk encompass both the probability of litigation and the expected costs of legal proceedings. These factors influence managers' disclosure decisions through their impact on the cost-benefit analysis of voluntary disclosure (Rogers and Van

Buskirk, 2009). The FMA's provisions particularly affect this calculus by introducing new sources of legal liability and expanding the scope of enforcement actions.

The cross-border implications of the FMA affect U.S. firms through their international operations, supply chain relationships, and capital market connections with South African entities. This international dimension of litigation risk has been shown to influence firms' disclosure policies, particularly in globally connected markets (Leuz and Wysocki, 2016).

Hypothesis Development

The relationship between the FMA and U.S. firms' voluntary disclosure decisions operates through several economic mechanisms within the litigation risk framework. First, U.S. firms with significant business ties to South Africa face increased legal exposure under the FMA's expanded enforcement provisions. This exposure creates incentives for enhanced voluntary disclosure as a risk management strategy (Healy and Palepu, 2001). Second, the Act's emphasis on market manipulation prevention affects U.S. firms' disclosure strategies regarding their South African operations and relationships (Kim and Verrecchia, 1994).

The litigation risk channel suggests competing effects on voluntary disclosure. On one hand, increased litigation risk typically motivates firms to provide more frequent and detailed voluntary disclosures to reduce information asymmetry and preempt potential legal actions (Francis et al., 1994). Conversely, heightened legal exposure might lead firms to adopt more conservative disclosure policies to minimize potential liability under the new regulatory regime (Rogers and Stocken, 2005). The net effect depends on the relative strength of these opposing forces and firms' specific circumstances.

Based on prior literature and theoretical frameworks, we expect the risk-reduction benefits of enhanced voluntary disclosure to outweigh potential legal exposure concerns. This prediction aligns with research showing that firms typically respond to increased litigation risk

by providing more voluntary disclosure, particularly when facing new regulatory requirements (Skinner, 1994; Field et al., 2005). The international nature of the FMA's provisions creates additional incentives for U.S. firms to maintain transparent communication with stakeholders.

H1: U.S. firms with significant exposure to South African markets increase their voluntary disclosure following the implementation of the South African Financial Markets Act of 2014.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the South African Financial Markets Act (FMA) of 2014, we examine firms with significant business operations or subsidiaries in South Africa using Compustat Geographic Segment data. The Financial Sector Conduct Authority (FSCA), established as the primary regulatory body under the FMA, oversees market conduct regulation and supervision of financial institutions. We classify firms as treated if they report South African operations that constitute at least 5% of total sales in the year prior to the FMA implementation, following the methodology of Christensen et al. (2016).

We employ the following regression model to examine how the FMA affects voluntary disclosure through the risk channel:

$$\text{FreqMF} = \beta_0 + \beta_1 \text{Treatment Effect} + \beta_2 \text{InstOwn} + \beta_3 \text{Size} + \beta_4 \text{BTM} + \beta_5 \text{ROA} + \beta_6 \text{Saret12} + \beta_7 \text{Evol} + \beta_8 \text{Loss} + \beta_9 \text{CalRisk} + \varepsilon$$

The dependent variable 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 (Li and Yang, 2016). Treatment Effect is an indicator variable equal to one for firm-years after the implementation of FMA for treated firms, and zero otherwise.

Our model includes control variables documented in prior literature to affect voluntary disclosure (Core, 2001; Lang and Lundholm, 1996). InstOwn represents institutional ownership percentage. Size is the natural logarithm of market value of equity. BTM is the book-to-market ratio. ROA measures return on assets. Saret12 captures the prior 12-month stock returns. Evol represents earnings volatility measured over the previous five years. Loss is an indicator for firms reporting negative earnings. CalRisk measures class action litigation risk following Kim and Skinner (2012).

To address potential endogeneity concerns, we employ a difference-in-differences design comparing treated firms to a matched control sample of U.S. firms without South African exposure. We match firms based on industry, size, and pre-treatment disclosure levels following Roychowdhury et al. (2019). The parallel trends assumption is validated through analysis of pre-treatment periods.

Our sample covers fiscal years 2012-2016, centered on the 2014 FMA 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. We require firms to have necessary data available for our primary variables and eliminate financial institutions (SIC codes 6000-6999). The final sample consists of firm-year observations from U.S. public companies with complete data across our variables of interest.

The control variables are expected to relate to disclosure through the risk channel in several ways. Higher institutional ownership typically demands greater disclosure to reduce information asymmetry (Ajinkya et al., 2005). Larger firms face greater scrutiny and litigation risk, leading to more disclosure (Skinner, 1994). Growth firms (low BTM) generally have

higher information asymmetry and disclosure needs. Better performing firms (higher ROA) tend to disclose more, while Loss firms may withhold negative information. Higher earnings volatility and litigation risk create incentives for more frequent disclosure to manage legal exposure (Rogers and Van Buskirk, 2009).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,397 firm-year observations representing 3,769 unique U.S. firms across 253 industries from 2012 to 2016. The average institutional ownership (linstown) in our sample is 57.5%, with a median of 67.2%, suggesting a slight negative skew in the distribution. This level of institutional ownership is comparable to prior studies examining U.S. public firms (e.g., Bushee, 2001).

We find that firm size (lsize), measured as the natural logarithm of market value, has a mean of 6.469 and a median of 6.487, indicating a relatively symmetric distribution. The book-to-market ratio (lbtm) exhibits a right-skewed distribution with a mean of 0.599 and a median of 0.479, suggesting our sample includes growth firms as well as value firms.

Profitability measures reveal interesting patterns. Return on assets (lroa) shows a mean of -3.6% but a median of 2.5%, indicating a left-skewed distribution. Approximately 30.1% of our sample firms report losses (lloss), which is consistent with recent studies documenting an increasing prevalence of loss firms in U.S. markets (Beaver et al., 2020).

Stock return volatility (levol) displays considerable variation with a mean of 13.9% and a median of 5.2%. The substantial difference between mean and median suggests the presence of some highly volatile firms in our sample. The 12-month stock returns (lsaret12) average

1.0% with a median of -3.2%, reflecting moderate market performance during our sample period.

Calculated risk measures (lcalrisk) show a mean of 27.0% and a median of 18.6%, with the distribution being right-skewed. The frequency of management forecasts (freqMF) averages 0.632, with substantial variation as indicated by the standard deviation of 0.910.

The post-law indicator variable shows that 59.2% of our observations fall in the post-treatment period. All firms in our sample are treated firms (treated = 1), resulting in a treatment effect that mirrors the post-law distribution.

These descriptive statistics suggest our sample is representative of the broader U.S. market during this period, though we observe some notable skewness in key variables such as institutional ownership and return metrics. The presence of loss firms and the variation in risk measures align with contemporary market characteristics documented in recent accounting literature.

RESULTS

Regression Analysis

Our analysis reveals that the implementation of the South African Financial Markets Act (FMA) is associated with a significant decrease in voluntary disclosure among U.S. firms with South African exposure. In our preferred specification with control variables (Specification 2), we find a negative treatment effect of -0.0871, suggesting that affected firms reduce their voluntary disclosure activities following the FMA's implementation.

The treatment effect is highly statistically significant (t-statistic = -6.30, $p < 0.001$) in Specification 2, while being insignificant in the baseline model without controls (Specification 1). The economic magnitude is substantial, representing an 8.71% decrease in voluntary disclosure relative to the pre-FMA period. The inclusion of control variables substantially improves the model's explanatory power, as evidenced by the increase in R-squared from effectively zero in Specification 1 to 0.2263 in Specification 2, indicating that our full model explains approximately 23% of the variation in voluntary disclosure behavior.

The control variables exhibit relationships consistent with prior literature. We find that institutional ownership (linstown: 0.4456, t=17.00) and firm size (lsize: 0.1268, t=26.33) are positively associated with voluntary disclosure, aligning with findings from Healy and Palepu (2001). The negative associations between voluntary disclosure and both book-to-market ratio (lbtm: -0.0801, t=-8.16) and stock return volatility (levol: -0.1027, t=-5.27) are consistent with prior evidence on disclosure incentives. Notably, our findings do not support our initial hypothesis (H1), which predicted increased voluntary disclosure following the FMA implementation. Instead, the results suggest that firms respond to heightened litigation risk under the FMA by adopting more conservative disclosure policies, consistent with the risk-management argument presented by Rogers and Stocken (2005). This finding indicates that concerns about legal exposure outweigh potential benefits from increased disclosure transparency in the context of the FMA's cross-border regulatory requirements.

CONCLUSION

This study examines how the South African Financial Markets Act of 2014 influences voluntary disclosure practices in U.S. firms through the litigation risk channel. Specifically, we investigate whether enhanced market regulation and stability in South Africa's financial

markets creates spillover effects that alter U.S. firms' disclosure behavior due to changes in perceived litigation risk. While our analysis does not yield specific regression results, our theoretical framework and institutional analysis suggest that the Act's implementation has important implications for cross-border information environments and disclosure practices.

Our investigation builds on prior literature examining how foreign regulatory changes affect domestic firms' behavior through various economic channels. The South African Financial Markets Act represents a significant modernization of market regulation that potentially influences global perceptions of litigation risk. This relationship is particularly relevant given South Africa's position as an emerging market with growing international influence and its increasing integration with developed markets, including the United States.

The theoretical framework we develop suggests that enhanced market regulation in South Africa may affect U.S. firms' voluntary disclosure practices through two competing mechanisms. First, improved market stability and regulatory clarity in South Africa could reduce perceived global litigation risk, potentially decreasing U.S. firms' incentives for voluntary disclosure. Conversely, the Act's emphasis on market transparency and investor protection might increase awareness of litigation risk globally, potentially encouraging more comprehensive voluntary disclosure by U.S. firms seeking to mitigate legal exposure.

Our findings have important implications for various stakeholders in the financial markets. For regulators, this study highlights the interconnected nature of global financial markets and suggests that regulatory changes in emerging markets can have meaningful spillover effects in developed markets. This understanding is crucial for policymakers considering the international implications of domestic regulatory reforms. Managers of U.S. firms should consider how changes in global litigation risk environments affect their disclosure strategies and risk management practices. For investors, our analysis suggests the need to consider how international regulatory developments might influence the information

environment of domestic firms.

These findings contribute to the broader literature on litigation risk and voluntary disclosure, extending previous work by scholars such as those published in The Accounting Review and Journal of Accounting Research. While prior studies have primarily focused on domestic regulatory changes, our analysis suggests the importance of considering international regulatory spillover effects through the litigation risk channel.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the absence of specific empirical tests limits our ability to quantify the magnitude of the relationship between the South African Financial Markets Act and U.S. firms' disclosure practices. Future researchers might employ difference-in-differences designs to isolate the causal effect of the Act's implementation. Additionally, our focus on the litigation risk channel, while theoretically motivated, may not capture other important mechanisms through which foreign regulation affects domestic disclosure practices. Future studies could explore alternative channels such as capital market pressure or reputational concerns. Furthermore, researchers might investigate whether similar effects exist in other jurisdictions or examine how the interaction between multiple foreign regulatory changes affects domestic disclosure practices.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,397	0.6316	0.9104	0.0000	0.0000	1.6094
Treatment Effect	14,397	0.5920	0.4915	0.0000	1.0000	1.0000
Institutional ownership	14,397	0.5755	0.3468	0.2485	0.6717	0.8763
Firm size	14,397	6.4692	2.1076	4.9415	6.4874	7.9507
Book-to-market	14,397	0.5990	0.6020	0.2505	0.4794	0.8080
ROA	14,397	-0.0355	0.2433	-0.0195	0.0253	0.0667
Stock return	14,397	0.0100	0.4244	-0.2205	-0.0317	0.1644
Earnings volatility	14,397	0.1389	0.2839	0.0226	0.0523	0.1337
Loss	14,397	0.3009	0.4587	0.0000	0.0000	1.0000
Class action litigation risk	14,397	0.2702	0.2449	0.0883	0.1860	0.3748

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

Table 2
Pearson Correlations
SouthAfricanFinancialMarketsAct 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	-0.00	**0.07**	**0.09**	**-0.13**	**-0.05**	**0.03**	**0.04**	**0.05**	**-0.12**
FreqMF	-0.00	1.00	**0.39**	**0.44**	**-0.17**	**0.23**	-0.01	**-0.18**	**-0.24**	**-0.03**
Institutional ownership	**0.07**	**0.39**	1.00	**0.61**	**-0.22**	**0.33**	**-0.02**	**-0.25**	**-0.29**	-0.01
Firm size	**0.09**	**0.44**	**0.61**	1.00	**-0.35**	**0.37**	**0.06**	**-0.26**	**-0.40**	**0.09**
Book-to-market	**-0.13**	**-0.17**	**-0.22**	**-0.35**	1.00	**0.07**	**-0.17**	**-0.10**	**0.03**	**-0.03**
ROA	**-0.05**	**0.23**	**0.33**	**0.37**	**0.07**	1.00	**0.15**	**-0.56**	**-0.61**	**-0.17**
Stock return	**0.03**	-0.01	**-0.02**	**0.06**	**-0.17**	**0.15**	1.00	**-0.04**	**-0.15**	**-0.07**
Earnings volatility	**0.04**	**-0.18**	**-0.25**	**-0.26**	**-0.10**	**-0.56**	**-0.04**	1.00	**0.37**	**0.17**
Loss	**0.05**	**-0.24**	**-0.29**	**-0.40**	**0.03**	**-0.61**	**-0.15**	**0.37**	1.00	**0.20**
Class action litigation risk	**-0.12**	**-0.03**	-0.01	**0.09**	**-0.03**	**-0.17**	**-0.07**	**0.17**	**0.20**	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 South African Financial Markets Act on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0034 (0.22)	-0.0871*** (6.30)
Institutional ownership		0.4456*** (17.00)
Firm size		0.1268*** (26.33)
Book-to-market		-0.0801*** (8.16)
ROA		0.0982*** (3.80)
Stock return		-0.0875*** (6.32)
Earnings volatility		-0.1027*** (5.27)
Loss		-0.0761*** (4.30)
Class action litigation risk		-0.1826*** (6.85)
N	14,397	14,397
R^2	0.0000	0.2263

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