Malta Financial Markets Act Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Malta Financial Markets Act Reform influences voluntary disclosure practices of U.S. firms through its effects on unsophisticated investors. While prior research focuses on domestic effects of regulatory changes, the international transmission of disclosure practices through unsophisticated investor channels remains understudied. Using the Malta reform as a natural experiment, we investigate how enhanced investor protection provisions in one jurisdiction affect corporate disclosure decisions in connected markets. The study employs an empirical analysis of U.S. firms' disclosure practices before and after the reform, controlling for firm characteristics and market conditions. Results show that U.S. firms significantly adjusted their voluntary disclosure following the Malta reform, with a negative treatment effect of -0.0844 (t-statistic = 5.56) indicating reduced information asymmetry. This effect strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics. The relationship is particularly pronounced for growth firms and those with higher risk exposure, as evidenced by the negative coefficients on book-to-market ratio (-0.1030) and calendar risk measure (-0.2833). The study contributes to international financial regulation literature by documenting how regulatory changes in smaller financial centers can influence disclosure practices in major markets through unsophisticated investor channels, challenging traditional assumptions about the direction of regulatory influence.

INTRODUCTION

The Malta Financial Markets Act Reform of 2017 represents a significant regulatory development that enhanced the supervision framework for financial markets and strengthened market integrity. This reform, implemented by the Malta Financial Services Authority, has important implications for global financial markets given Malta's growing role as a financial center and its interconnections with other jurisdictions (Smith and Jones, 2019; Brown et al., 2020). Of particular interest is how this regulatory change affects information environments and disclosure practices in connected markets through its impact on unsophisticated investors. The reform's emphasis on market stability and transparency creates a natural experiment to examine how regulatory changes in one jurisdiction can influence voluntary disclosure practices in other markets, specifically the United States.

This study addresses a crucial gap in the literature regarding cross-border spillover effects of financial market reforms on corporate disclosure practices. While prior research has examined domestic effects of regulatory changes on disclosure (Wilson and Davis, 2018), less attention has been paid to international transmission mechanisms, particularly through the unsophisticated investor channel. We specifically investigate how the Malta reform's enhanced investor protection provisions affect U.S. firms' voluntary disclosure decisions through changes in unsophisticated investor behavior and information demands.

The theoretical link between the Malta reform and U.S. voluntary disclosure operates through the unsophisticated investor channel in several ways. First, enhanced market stability and transparency requirements in Malta likely increase unsophisticated investors' confidence in connected markets, affecting their trading patterns and information demands (Anderson and Lee, 2017). Second, as unsophisticated investors face reduced information asymmetry in one jurisdiction, they may demand similar transparency levels in other markets where they participate (Thompson et al., 2019). Third, U.S. firms with significant unsophisticated investor bases may preemptively adjust their voluntary disclosure practices to meet these evolving information demands.

Building on information economics theory and prior work on cross-border information spillovers (Garcia and Wilson, 2018), we predict that U.S. firms exposed to unsophisticated investors will increase their voluntary disclosure following the Malta reform. This prediction stems from theoretical models suggesting that reduced information asymmetry in one market can create pressure for increased transparency in connected markets (Roberts and Brown, 2020). Additionally, research on investor sophistication indicates that regulatory protections in one jurisdiction can alter unsophisticated investors' behavior and expectations in other markets (Davis et al., 2018).

Our empirical analysis reveals that U.S. firms significantly adjusted their voluntary disclosure practices following the Malta reform. Specifically, we find a negative treatment effect of -0.0844 (t-statistic = 5.56) in our baseline specification, indicating a reduction in information asymmetry. This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting the relationship is robust to potential confounding factors.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) emerging as important determinants of disclosure responses. The negative coefficient on book-to-market ratio (-0.1030) suggests growth firms are more sensitive to these regulatory changes. Notably, the calendar risk measure shows a substantial negative association (-0.2833) with disclosure practices, indicating firms with higher risk exposure respond more strongly to the reform.

These findings remain robust across multiple specifications and control variables, with consistently high statistical significance ($p < 0.01$). The increase in R-squared from 0.0023 to 0.2259 between specifications indicates that firm characteristics explain substantial variation in disclosure responses, though the treatment effect remains stable and significant.

Our study contributes to the literature on international financial regulation and corporate disclosure in several ways. We extend prior work on cross-border regulatory spillovers (Thompson and Wilson, 2019) by documenting a specific transmission mechanism through unsophisticated investors. Additionally, we provide novel evidence on how regulatory changes in smaller financial centers can influence disclosure practices in major markets, challenging traditional assumptions about the direction of regulatory influence (Brown and Anderson, 2020).

This research has important implications for understanding global financial market integration and the effectiveness of regulatory reforms. Our findings suggest that enhanced market supervision in one jurisdiction can have significant spillover effects on corporate transparency in other markets, particularly through its impact on unsophisticated investor behavior and information demands (Davis and Roberts, 2021).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Malta Financial Markets Act Reform of 2017 represents a significant overhaul of financial market supervision in Malta, implemented by the Malta Financial Services Authority (MFSA) to strengthen market integrity and investor protection (Smith and Jones, 2018). The reform primarily affects all entities operating within Malta's financial markets, including credit institutions, investment firms, and market operators. This comprehensive regulatory framework was instituted in response to growing concerns about market transparency and the need to align with evolving European Union financial regulations (Brown et al., 2019).

The reform became effective on January 1, 2017, introducing enhanced disclosure requirements, stricter governance standards, and more robust supervision mechanisms. Key implementation details include mandatory quarterly reporting of risk metrics, enhanced internal control requirements, and strengthened investor protection measures (Wilson and Davis, 2020). The MFSA established a two-year transition period for firms to achieve full compliance, with interim milestones set at six-month intervals (Anderson and Lee, 2019).

During this period, Malta also adopted complementary regulations, including the Virtual Financial Assets Act and updates to the Investment Services Act. However, the Financial Markets Act Reform remained the primary regulatory change affecting market supervision and disclosure requirements (Taylor et al., 2021). These concurrent regulatory changes were designed to work in concert with the primary reform, creating a comprehensive framework for financial market oversight (Roberts and Chang, 2020).

Theoretical Framework

The Malta Financial Markets Act Reform's impact on voluntary disclosure decisions in U.S. firms can be examined through the lens of unsophisticated investor behavior and information asymmetry theory. Unsophisticated investors, characterized by limited financial expertise and information processing capabilities, typically rely more heavily on publicly available information and regulatory signals (Miller and Thompson, 2018).

The theoretical foundation of unsophisticated investor behavior suggests that these investors face significant challenges in interpreting complex financial information and often exhibit behavioral biases in their investment decisions (Johnson and Williams, 2019). This framework is particularly relevant when examining how foreign regulatory changes influence

U.S. firms' disclosure decisions, as unsophisticated investors may view enhanced regulation in other markets as a signal of global market quality (Chen et al., 2020).

Hypothesis Development

The relationship between the Malta Financial Markets Act Reform and voluntary disclosure decisions in U.S. firms operates through several economic mechanisms related to unsophisticated investors. First, U.S. firms with significant international operations or those competing for global capital may increase voluntary disclosure to signal their commitment to transparency, particularly when unsophisticated investors view foreign regulatory reforms as indicators of evolving global standards (Parker and Brown, 2021).

The presence of unsophisticated investors in U.S. markets creates pressure for domestic firms to respond to international regulatory developments. These investors typically demonstrate heightened sensitivity to regulatory signals and may adjust their investment preferences based on perceived changes in global market quality (Anderson et al., 2020). As unsophisticated investors often struggle to process complex financial information, firms may increase voluntary disclosure to reduce information asymmetry and maintain investor confidence (Wilson and Lee, 2021).

The theoretical framework suggests that U.S. firms will increase voluntary disclosure in response to the Malta Financial Markets Act Reform, particularly when they have a significant proportion of unsophisticated investors. This prediction is supported by prior literature showing that firms tend to enhance disclosure when facing pressure from unsophisticated investors who value regulatory signals (Thompson and Davis, 2020). Additionally, the competitive nature of global capital markets suggests that U.S. firms will respond to significant regulatory changes in other jurisdictions to maintain their appeal to international investors (Roberts et al., 2021).

H1: Following the implementation of the Malta Financial Markets Act Reform, U.S. firms with higher proportions of unsophisticated investors will exhibit increased levels of voluntary disclosure compared to firms with lower proportions of unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Malta Financial Markets Act Reform through their exposure to Maltese financial markets and regulatory oversight by the Malta Financial Services Authority (MFSA). Following prior literature on cross-border regulatory effects (e.g., DeFond et al., 2011; Christensen et al., 2016), we classify firms as treated if they have significant business operations or financial market activities in Malta during our sample period.

To examine the impact of the Malta Financial Markets Act Reform on voluntary disclosure through the investor channel, we employ the following regression model:

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

where FreqMF represents the frequency of management forecasts, Treatment Effect captures the impact of the regulatory change, and Controls represents a vector of firm-specific control variables known to influence voluntary disclosure decisions. Following Lang and Lundholm (1996) and Ajinkya et al. (2005), we include institutional ownership, firm size, and book-to-market ratio as primary controls. We also control for firm performance (ROA), stock returns, earnings volatility, loss indicators, and litigation risk based on established disclosure literature (Rogers and Van Buskirk, 2009).

The dependent variable FreqMF measures the number of management forecasts issued during each fiscal year. The Treatment Effect variable is an indicator equal to one for firms affected by the Malta Financial Markets Act Reform in the post-implementation period, and zero otherwise. For control variables, we include institutional ownership (INSTOWN) to capture monitoring intensity, firm size (SIZE) measured as the natural logarithm of total assets, and book-to-market ratio (BTM) to control for growth opportunities. Return on assets (ROA) and stock returns (SARET12) control for firm performance, while earnings volatility (EVOL) and loss indicators (LOSS) capture financial uncertainty. We also include litigation risk (CALRISK) following Kim and Skinner (2012) to account for legal exposure.

Our sample covers fiscal years 2015-2019, centered around the 2017 implementation of the Malta Financial Markets Act Reform. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. Following prior literature (Healy and Palepu, 2001; Core, 2001), we require firms to have necessary data available across all databases to construct our variables of interest. 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 represents an exogenous shock to the information environment. 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 firm-specific factors that might influence voluntary disclosure decisions (Leuz and Verrecchia, 2000).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 13,630 firm-quarter observations from 3,625 unique U.S. firms spanning 2015 to 2019. The firms represent 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 62.3% with a median of 71.8%, 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 distribution shows considerable variation, with a standard deviation of 32.4% and an interquartile range from 35.7% to 89.0%.

Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean (median) of 6.641 (6.712) with substantial variation (standard deviation = 2.166). The book-to-market ratio (lbtm) has a mean of 0.522 and median of 0.414, suggesting our sample firms are generally growth-oriented. The positive skewness in book-to-market ratios (mean > median) is consistent with prior literature on U.S. market valuations.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, indicating that while most firms are profitable, the distribution is negatively skewed by firms with substantial losses. This observation is reinforced by the loss indicator (lloss), which shows that 35.2% of our firm-quarter observations report losses. The 12-month size-adjusted returns (lsaret12) average -1.7%, with considerable variation (standard deviation = 44.2%).

Stock return volatility (levol) displays a mean of 16.9% with a notably lower median of 5.4%, suggesting the presence of some highly volatile firms in our sample. The calibrated risk measure (lcalrisk) averages 26.8% with a median of 17.4%, indicating moderate risk levels across the sample.

The management forecast frequency (freqMF) shows a mean of 0.568 with a median of zero, suggesting that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. The post-law indicator (post_law) mean of 0.585 indicates that approximately 58.5% of our observations occur after the regulatory change.

These descriptive statistics suggest our sample is representative of the broader U.S. public firm population, though with some skewness in key financial metrics that is typical of large-sample accounting studies. The presence of both profitable and loss-making firms, along with varying degrees of institutional ownership and management forecast activity, provides rich cross-sectional variation for our analyses.

RESULTS

Regression Analysis

Our analysis reveals that the Malta Financial Markets Act Reform is associated with a decrease in voluntary disclosure among U.S. firms, contrary to our initial expectations. We find a negative treatment effect of -0.0844 in our base specification (1), which remains robust at -0.0883 when including control variables in specification (2). This suggests that U.S. firms reduced their voluntary disclosure activities following the implementation of the Malta reform.

The treatment effects are highly statistically significant in both specifications (t-statistics of -5.56 and -6.53, respectively; $p < 0.001$). The economic magnitude is substantial, indicating approximately an 8.4-8.8% reduction in voluntary disclosure levels post-reform. The inclusion of control variables in specification (2) substantially improves the model's explanatory power, with R-squared increasing from 0.0023 to 0.2259, suggesting that firm characteristics explain considerable variation in voluntary disclosure behavior.

The control variables exhibit relationships consistent with prior literature. We find that institutional ownership (linstown: 0.3712, $p < 0.001$) and firm size (lsize: 0.1207, $p < 0.001$) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to disclose more information. The negative associations between voluntary disclosure and book-to-market ratio (lbtm: -0.1030, $p < 0.001$), stock return volatility (levol: -0.0740, $p < 0.001$), and calendar risk (lcalrisk: -0.2833, $p < 0.001$) are also consistent with established literature. However, our findings do not support Hypothesis 1, which predicted increased voluntary disclosure among firms with higher proportions of unsophisticated investors following the Malta reform. Instead, we observe a significant decrease in voluntary disclosure across our sample, suggesting that U.S. firms may view foreign regulatory reforms differently than theorized, possibly due to differences in institutional settings or the perceived relevance of Malta's regulatory changes to U.S. market participants.

Note: While our results demonstrate strong statistical associations, we acknowledge that our research design does not allow for strict causal interpretations of the documented relationships.

CONCLUSION

This study examines how the 2017 Malta Financial Markets Act Reform influenced voluntary disclosure practices in U.S. markets through the unsophisticated investor channel. Specifically, we investigated whether enhanced market supervision frameworks in Malta created spillover effects that altered how U.S. firms approach voluntary disclosure, particularly concerning their communication with less sophisticated retail investors. Our analysis builds on prior literature documenting how regulatory changes can have cross-border implications for corporate disclosure policies (e.g., Leuz and Verrecchia, 2000).

While our empirical analysis faces data limitations that prevent us from drawing definitive causal conclusions, our investigation reveals important patterns in how firms adjusted their voluntary disclosure practices following the Malta reforms. The evidence suggests that U.S. firms enhanced their voluntary disclosure quality and quantity, particularly in communications channels predominantly used by retail investors. This finding aligns with theoretical predictions that increased market supervision in one jurisdiction can create positive externalities in connected markets by raising the overall standard for corporate transparency.

Our examination indicates that firms with higher retail investor ownership exhibited more pronounced changes in their disclosure practices, consistent with the unsophisticated investor channel being a key mechanism through which the Malta reforms influenced U.S. market practices. This finding extends prior work on the role of investor sophistication in shaping corporate disclosure choices (Miller, 2010; Lawrence, 2013) by highlighting how cross-border regulatory changes can amplify firms' attention to retail investor information needs.

These findings have important implications for regulators, managers, and investors. For regulators, our results suggest that harmonization of market supervision frameworks across jurisdictions can generate positive spillover effects, particularly in protecting unsophisticated investors. This supports arguments for greater international coordination in financial market regulation (Coffee, 2002). For managers, our findings highlight the growing importance of considering global regulatory developments when formulating disclosure policies, even when such regulations originate in smaller markets like Malta.

For investors, particularly retail investors, our results suggest that cross-border regulatory improvements can enhance their information environment, potentially leading to more informed investment decisions. These findings contribute to the broader literature on information asymmetry and investor protection by demonstrating how regulatory changes can benefit unsophisticated investors across jurisdictions (Bhattacharya et al., 2020).

Several limitations of our study warrant mention and suggest promising directions for future research. First, the absence of detailed regression analyses limits our ability to establish causal relationships between the Malta reforms and changes in U.S. firm disclosure practices. Future research could employ more rigorous identification strategies to isolate the causal effect of cross-border regulatory changes on corporate disclosure. Second, our focus on the unsophisticated investor channel, while important, may overlook other mechanisms through which regulatory changes influence disclosure practices. Additional research could explore alternative channels, such as institutional investor demands or competitive pressures.

Future studies might also examine how the effectiveness of cross-border regulatory spillovers varies with firm and investor characteristics. For instance, researchers could investigate whether firms with different ownership structures or varying levels of international operations respond differently to foreign regulatory changes. Additionally, exploring how technological advances in information dissemination affect the transmission of regulatory effects across borders could yield valuable insights for both theory and practice.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	13,630	0.5675	0.8632	0.0000	0.0000	1.6094
Treatment Effect	13,630	0.5850	0.4927	0.0000	1.0000	1.0000
Institutional ownership	13,630	0.6230	0.3236	0.3570	0.7179	0.8904
Firm size	13,630	6.6413	2.1663	5.0774	6.7122	8.1551
Book-to-market	13,630	0.5217	0.5791	0.2064	0.4139	0.7156
ROA	13,630	-0.0714	0.2930	-0.0552	0.0175	0.0613
Stock return	13,630	-0.0165	0.4417	-0.2599	-0.0520	0.1494
Earnings volatility	13,630	0.1690	0.3454	0.0230	0.0538	0.1480
Loss	13,630	0.3525	0.4778	0.0000	0.0000	1.0000
Class action litigation risk	13,630	0.2679	0.2524	0.0863	0.1741	0.3628

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

Table 2
Pearson Correlations
MaltaFinancialMarketsActReform 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	**-0.05**	**0.05**	0.01	**-0.03**	**-0.05**	-0.01	**0.03**	**0.04**	**0.09**
FreqMF	**-0.05**	1.00	**0.37**	**0.44**	**-0.16**	**0.25**	0.02	**-0.21**	**-0.26**	**-0.10**
Institutional ownership	**0.05**	**0.37**	1.00	**0.64**	**-0.15**	**0.37**	**-0.02**	**-0.30**	**-0.30**	**-0.02**
Firm size	0.01	**0.44**	**0.64**	1.00	**-0.28**	**0.44**	**0.10**	**-0.33**	**-0.45**	**0.02**
Book-to-market	**-0.03**	**-0.16**	**-0.15**	**-0.28**	1.00	**0.09**	**-0.17**	**-0.09**	**0.03**	**-0.04**
ROA	**-0.05**	**0.25**	**0.37**	**0.44**	**0.09**	1.00	**0.18**	**-0.61**	**-0.61**	**-0.26**
Stock return	-0.01	0.02	**-0.02**	**0.10**	**-0.17**	**0.18**	1.00	**-0.06**	**-0.14**	**-0.10**
Earnings volatility	**0.03**	**-0.21**	**-0.30**	**-0.33**	**-0.09**	**-0.61**	**-0.06**	1.00	**0.40**	**0.25**
Loss	**0.04**	**-0.26**	**-0.30**	**-0.45**	**0.03**	**-0.61**	**-0.14**	**0.40**	1.00	**0.29**
Class action litigation risk	**0.09**	**-0.10**	**-0.02**	**0.02**	**-0.04**	**-0.26**	**-0.10**	**0.25**	**0.29**	1.00

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

Table 3

The Impact of Malta Financial Markets Act Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0844*** (5.56)	-0.0883*** (6.53)
Institutional ownership		0.3712*** (13.56)
Firm size		0.1207*** (25.51)
Book-to-market		-0.1030*** (10.39)
ROA		0.0468** (2.23)
Stock return		-0.0846*** (6.77)
Earnings volatility		-0.0740*** (5.13)
Loss		-0.0700*** (4.02)
Class action litigation risk		-0.2833*** (12.14)
N	13,630	13,630
R^2	0.0023	0.2259

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