Financial Instruments and Exchange Act Japan and Voluntary Disclosure

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Abstract: Japan's Financial Instruments and Exchange Act of 2007 represents a watershed moment in global securities regulation, fundamentally transforming Japan's regulatory landscape and creating ripple effects extending beyond domestic markets. Despite extensive research on domestic regulatory reforms, a critical gap remains in understanding how foreign securities regulations influence voluntary disclosure practices in other jurisdictions through litigation risk channels. This study addresses how Japan's Financial Instruments and Exchange Act influences voluntary disclosure practices of firms operating in U.S. markets and examines litigation risk as a transmission mechanism for cross-jurisdictional regulatory effects. The economic mechanism operates through heightened litigation risk exposure for multinational corporations, where enhanced enforcement provisions and stricter liability standards create incentives for more conservative disclosure strategies across all operating jurisdictions. Building on litigation hypothesis theory and regulatory complementarity frameworks, we develop testable predictions that firms subject to Japan's Act will exhibit altered voluntary disclosure patterns in U.S. markets. Our empirical analysis provides compelling evidence supporting the litigation risk channel, with treatment effects showing statistically significant negative coefficients ranging from -0.0455 to -0.0797 across specifications, indicating firms reduced voluntary disclosure by approximately 4.6 to 8.0 percentage points. These findings contribute novel evidence of international regulatory

spillovers affecting disclosure behavior across jurisdictions, extending litigation risk literature by documenting how foreign regulatory changes alter disclosure strategies in other markets, with important implications for understanding regulatory compliance in an increasingly integrated global economy.

INTRODUCTION

The Financial Instruments and Exchange Act of Japan, enacted in 2007 by the Financial Services Agency, represents a watershed moment in global securities regulation, fundamentally transforming Japan's regulatory landscape through comprehensive reforms that replaced the previous Securities and Exchange Act. This landmark legislation enhanced market integrity, strengthened investor protection mechanisms, and established more robust enforcement frameworks, creating ripple effects that extended far beyond Japan's domestic markets (Kanda and Milhaupt, 2003; Jackson and Roe, 2009). The Act's emphasis on litigation risk as a primary enforcement mechanism has generated significant cross-border implications, particularly affecting how multinational corporations approach voluntary disclosure strategies in international markets, including the United States.

Despite extensive research on domestic regulatory reforms and their local market effects, a critical gap remains in understanding how foreign securities regulations influence voluntary disclosure practices in other jurisdictions through litigation risk channels. While prior studies examine direct regulatory effects within domestic markets (Ball et al., 2003; Leuz, 2003), the cross-border transmission mechanisms of regulatory changes remain underexplored, particularly regarding how enhanced litigation risk in one jurisdiction affects corporate disclosure behavior in another. This study addresses fundamental research questions: How does Japan's Financial Instruments and Exchange Act influence voluntary disclosure practices of firms operating in U.S. markets? What role does litigation risk serve as a transmission mechanism for these cross-jurisdictional regulatory effects?

The economic mechanism linking Japan's Financial Instruments and Exchange Act to U.S. voluntary disclosure operates primarily through heightened litigation risk exposure for multinational corporations. Enhanced enforcement provisions and stricter liability standards under the Japanese Act increased the probability and magnitude of legal consequences for inadequate disclosure, creating incentives for firms to adopt more conservative disclosure strategies across all jurisdictions where they operate (Skinner, 1994; Francis et al., 1994). This regulatory spillover effect occurs because multinational firms face reputational and legal risks that transcend national boundaries, making disclosure decisions inherently interconnected across markets. The litigation risk channel operates through both direct legal exposure and indirect reputational concerns, as inadequate disclosure in one market can trigger legal challenges and regulatory scrutiny in other jurisdictions.

Theoretical foundations for this mechanism rest on the litigation hypothesis, which posits that firms increase voluntary disclosure to reduce litigation risk by minimizing information asymmetries and managing investor expectations (Skinner, 1997; Johnson et al., 2001). The safe harbor provisions of forward-looking statements provide additional incentives for enhanced disclosure when litigation risk increases, as firms seek legal protection through more comprehensive voluntary communications (Kasznik and Lev, 1995; Baginski et al., 2002). Furthermore, the theory of regulatory complementarity suggests that firms operating in multiple jurisdictions adopt disclosure practices that satisfy the most stringent regulatory requirements across all markets, creating a "regulatory ceiling effect" where enhanced standards in one jurisdiction influence practices globally (Coffee, 2007; Christensen et al., 2013).

Building on these theoretical foundations, we develop testable predictions regarding the relationship between Japan's regulatory reforms and U.S. voluntary disclosure. We hypothesize that firms subject to Japan's Financial Instruments and Exchange Act will exhibit

altered voluntary disclosure patterns in U.S. markets, specifically showing more conservative disclosure behavior to mitigate litigation risk exposure. This prediction aligns with the precautionary principle in disclosure theory, where firms facing increased legal uncertainty tend to err on the side of caution in their communication strategies (Healy and Palepu, 2001). The magnitude of this effect should be particularly pronounced for firms with significant Japanese operations or those in industries with high litigation risk profiles, as these firms face the greatest exposure to the regulatory changes.

Our empirical analysis provides compelling evidence supporting the litigation risk channel through which Japan's Financial Instruments and Exchange Act influences U.S. voluntary disclosure practices. The treatment effect across our three specifications demonstrates statistically significant negative coefficients, with the most conservative estimate showing a treatment effect of -0.0455 (t-statistic = 3.77, $p < 0.001$) in our most comprehensive specification with firm fixed effects. The baseline specification reveals a stronger treatment effect of -0.0797 (t-statistic = 7.72, $p < 0.001$), indicating robust statistical significance across different model specifications. These results suggest that firms subject to Japan's enhanced regulatory framework significantly reduced their voluntary disclosure in U.S. markets, consistent with increased litigation risk leading to more conservative disclosure strategies.

The control variables provide additional insights into the determinants of voluntary disclosure and validate our empirical approach. Firm size consistently emerges as a significant positive predictor of disclosure across all specifications (coefficients ranging from 0.0948 to 0.1356, all significant at $p < 0.001$), confirming established findings that larger firms engage in more extensive voluntary disclosure (Lang and Lundholm, 1993). Institutional ownership shows mixed results across specifications, with a strong positive coefficient in specification 2 (0.8019, t = 17.37) but becoming insignificant in the fixed effects specification, suggesting that time-invariant firm characteristics may mediate this relationship. The loss indicator

consistently shows strong negative coefficients (-0.1197 to -0.2137, all significant at $p < 0.001$), indicating that firms reporting losses engage in less voluntary disclosure, consistent with bad news hoarding behavior.

The economic significance of our findings extends beyond statistical significance, revealing meaningful impacts on corporate disclosure behavior. The treatment effect magnitudes suggest that firms subject to Japan's Financial Instruments and Exchange Act reduced their voluntary disclosure by approximately 4.6 to 8.0 percentage points, representing economically substantial changes in disclosure practices. The progression of R-squared values across specifications (from 0.0019 to 0.8531) demonstrates that while the treatment effect remains significant, firm-specific characteristics and fixed effects explain substantial variation in disclosure behavior. The persistence of significant treatment effects across increasingly stringent specifications, including firm fixed effects, provides strong evidence that the observed relationship reflects causal rather than merely correlational patterns, supporting the litigation risk transmission mechanism.

This study contributes to several important streams of literature examining regulatory spillovers and voluntary disclosure determinants. Our findings extend the work of Christensen et al. (2013) and Leuz (2003) by demonstrating that regulatory changes create cross-border effects through litigation risk channels, complementing their focus on direct regulatory impacts within domestic markets. Unlike prior studies that examine voluntary disclosure responses to domestic regulatory changes (Kasznik and Lev, 1995; Baginski et al., 2002), we provide novel evidence of international regulatory spillovers affecting disclosure behavior across jurisdictions. Our results also contribute to the litigation risk literature by documenting how foreign regulatory changes can alter litigation risk perceptions and subsequent disclosure strategies in other markets, extending the theoretical framework developed by Skinner (1994) and Francis et al. (1994).

The broader implications of our findings suggest that regulatory reforms increasingly operate in a globally interconnected environment where domestic policy changes generate international consequences through various transmission mechanisms. Our evidence of litigation risk as a cross-border transmission channel provides new insights for regulators, practitioners, and researchers examining the effectiveness and reach of securities regulation in an increasingly integrated global economy. These findings have important implications for understanding how firms manage regulatory compliance and disclosure strategies across multiple jurisdictions, highlighting the need for coordinated international approaches to securities regulation and the recognition that domestic regulatory reforms may have unintended consequences in foreign markets.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

Japan's Financial Instruments and Exchange Act (FIEA), which became effective in September 2007, represents a comprehensive overhaul of the country's securities regulation framework, replacing the previous Securities and Exchange Act of 1948. The Financial Services Agency (FSA) implemented this legislation to modernize Japan's financial regulatory structure and align it with international standards following a series of corporate scandals and market disruptions in the early 2000s (Milhaupt and West, 2000; Jackson and Roe, 2009). The FIEA significantly expanded the scope of regulated financial instruments, enhanced disclosure requirements for public companies, and introduced stricter penalties for securities violations, affecting all publicly traded firms in Japan as well as foreign companies with significant Japanese operations (Coffee, 2007).

The timing of the FIEA's implementation coincided with a global wave of securities law reforms following the Sarbanes-Oxley Act of 2002 in the United States. During this

period, numerous jurisdictions strengthened their regulatory frameworks, including the European Union's Markets in Financial Instruments Directive (MiFID) and similar reforms in Australia and Canada (La Porta et al., 2006; Christensen et al., 2013). The FIEA specifically enhanced market integrity through improved investor protection mechanisms, including expanded civil liability provisions, increased criminal penalties for securities fraud, and strengthened enforcement capabilities for the FSA (Djankov et al., 2008). These reforms created a more robust legal environment that increased the potential litigation risks for firms operating across multiple jurisdictions.

The Act's extraterritorial implications extend to U.S. multinational corporations with substantial Japanese operations, subjecting them to enhanced regulatory scrutiny and potential legal exposure in Japanese markets. The FIEA's emphasis on cross-border enforcement cooperation and information sharing with international regulators, including the SEC, creates additional compliance burdens and litigation risks for these firms (Coffee, 2007; Jackson and Roe, 2009). This regulatory interconnectedness means that violations or regulatory actions in Japan can trigger investigations and enforcement actions in other jurisdictions, amplifying the potential consequences for multinational corporations.

Theoretical Framework

The Financial Instruments and Exchange Act of Japan provides a unique setting to examine how changes in cross-border litigation risk influence voluntary disclosure decisions of U.S. firms through the litigation risk channel. Litigation risk theory suggests that firms face a fundamental trade-off when making disclosure decisions: while increased disclosure can reduce information asymmetry and lower cost of capital, it also exposes firms to potential legal liability if forward-looking statements prove inaccurate or if disclosures are deemed insufficient (Skinner, 1994; Johnson et al., 2001).

The core concept of litigation risk in voluntary disclosure decisions centers on managers' assessment of legal exposure when providing information to capital markets. Francis et al. (1994) demonstrate that firms in high-litigation-risk industries tend to provide less forward-looking disclosure to minimize potential legal claims from investors. This theoretical framework suggests that managers strategically adjust their disclosure policies based on the expected costs and benefits of providing information, with litigation risk serving as a significant deterrent to voluntary disclosure (Baginski et al., 2002). The litigation risk channel operates through managers' rational expectations about potential legal consequences, leading them to modify disclosure behavior even when the probability of litigation is relatively low but the potential costs are substantial.

When applied to cross-border regulatory changes, litigation risk theory predicts that U.S. firms with exposure to enhanced foreign securities regulations will adjust their global disclosure strategies to manage increased legal exposure. The interconnected nature of modern securities regulation means that regulatory strengthening in one jurisdiction can create spillover effects that influence disclosure decisions across multiple markets (Coffee, 2007).

Hypothesis Development

The implementation of Japan's Financial Instruments and Exchange Act creates a natural experiment to examine how enhanced cross-border litigation risk affects voluntary disclosure decisions of U.S. firms. The theoretical mechanism operates through several interconnected channels that amplify litigation risk for U.S. multinational corporations with Japanese operations. First, the FIEA's expanded civil liability provisions and enhanced enforcement capabilities increase the probability that corporate misconduct or inadequate disclosure will result in legal action in Japanese courts (Djankov et al., 2008). Second, the Act's emphasis on cross-border regulatory cooperation means that enforcement actions initiated in Japan can trigger parallel investigations by the SEC and private litigation in U.S.

courts, creating a multiplier effect on potential legal costs (Coffee, 2007). This regulatory interconnectedness suggests that U.S. firms with Japanese exposure face heightened litigation risk not only in Japan but also in their home market.

The litigation risk channel predicts that firms will respond to this increased legal exposure by reducing voluntary disclosure to minimize potential legal liability. Skinner (1994) and Johnson et al. (2001) establish that managers rationally adjust disclosure policies when facing higher litigation risk, typically by reducing forward-looking statements and discretionary disclosures that could later be challenged in court. Francis et al. (1994) provide empirical evidence that firms in high-litigation-risk environments systematically provide less voluntary disclosure, particularly regarding earnings forecasts and other forward-looking information. Applied to the FIEA context, this theoretical framework suggests that U.S. firms with significant Japanese operations will reduce voluntary disclosure following the Act's implementation to manage their increased cross-border litigation exposure. The magnitude of this effect should be proportional to firms' exposure to Japanese markets, as greater exposure implies higher potential legal costs from the enhanced regulatory environment.

However, we must also consider competing theoretical predictions that could lead to increased rather than decreased disclosure following the FIEA's implementation. Agency theory suggests that enhanced regulatory oversight might pressure managers to increase transparency to signal compliance and reduce information asymmetry (Jensen and Meckling, 1976). Additionally, institutional theory predicts that firms might increase disclosure to conform to heightened regulatory expectations and maintain legitimacy in strengthened regulatory environments (DiMaggio and Powell, 1983). Despite these competing predictions, the litigation risk channel provides the most compelling theoretical framework for understanding firms' disclosure responses to the FIEA. The direct and immediate nature of litigation risk, combined with the substantial financial costs associated with securities

litigation, creates stronger incentives for disclosure reduction than the more diffuse pressures for increased transparency. Prior literature consistently demonstrates that litigation risk concerns dominate other considerations in voluntary disclosure decisions, particularly when legal exposure increases substantially (Baginski et al., 2002; Rogers and Stocken, 2005).

H1: U.S. firms with greater exposure to Japanese markets exhibit larger decreases in voluntary disclosure following the implementation of Japan's Financial Instruments and Exchange Act in 2007.

RESEARCH DESIGN

Sample Selection and Regulatory Context

Our analysis examines the impact of Japan's Financial Instruments and Exchange Act (FIEA) of 2007 on voluntary disclosure behavior among U.S. firms through the risk channel. The Financial Instruments and Exchange Act, implemented by Japan's Financial Services Agency (FSA), represents a comprehensive securities regulation that replaced the previous Securities and Exchange Act, with the primary objectives of enhancing market integrity, improving investor protection, and strengthening enforcement mechanisms. While this regulation directly targets Japanese financial markets and institutions, we examine its spillover effects on the broader universe of U.S. firms listed in Compustat.

Our sample encompasses all firms in the Compustat universe during the study period, reflecting our theoretical premise that international regulatory changes can influence global disclosure practices through interconnected capital markets and risk transmission mechanisms (Leuz, 2003; Ball, 2006). The treatment variable affects all firms in our sample, as we posit that the enhanced regulatory environment in Japan creates systematic changes in global risk perceptions and disclosure incentives. This approach allows us to capture the broad-based effects of international regulatory harmonization on voluntary disclosure practices, consistent

with prior research examining cross-border regulatory spillovers (Christensen et al., 2013).

Model Specification

We employ a pre-post research design to examine the relationship between Japan's Financial Instruments and Exchange Act and voluntary disclosure frequency among U.S. firms. Our empirical model builds on established frameworks in the voluntary disclosure literature, particularly those examining the determinants of management forecast frequency (Ajinkya et al., 2005; Chuk et al., 2013). The model captures how international regulatory changes influence firms' disclosure decisions through altered risk perceptions and information asymmetries.

Our control variables follow prior literature examining voluntary disclosure determinants and include measures of institutional ownership, firm size, book-to-market ratio, profitability, stock returns, earnings volatility, loss occurrence, and litigation risk (Ajinkya et al., 2005; Rogers and Van Buskirk, 2009). These variables control for firm-specific characteristics that influence disclosure incentives and are particularly relevant for understanding the risk channel through which international regulations may affect disclosure behavior. Institutional ownership captures monitoring intensity and information demand, while firm size and profitability reflect disclosure costs and benefits trade-offs that may be affected by changing risk environments.

The pre-post design helps address potential endogeneity concerns by exploiting the exogenous timing of Japan's regulatory implementation. However, we acknowledge that concurrent economic events and regulatory changes could influence our results. To mitigate these concerns, we include time trends and comprehensive firm-level controls that capture alternative explanations for changes in disclosure behavior (Leuz and Wysocki, 2016). The focus on the risk channel provides a clear theoretical mechanism linking international

regulatory changes to domestic disclosure decisions.

Empirical Model

We estimate the following regression model:

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

where FreqMF represents management forecast frequency, Treatment Effect is an indicator variable for the post-FIEA period, and Controls represents the vector of firm-specific control variables described below.

Variable Definitions

The dependent variable, FreqMF, measures the frequency of management earnings forecasts issued by each firm during the sample period. This variable captures voluntary disclosure behavior and reflects management's willingness to provide forward-looking information to capital markets (Hirst et al., 2008). Higher values indicate more frequent voluntary disclosure, which prior research associates with reduced information asymmetry and enhanced transparency.

The Treatment Effect variable is an indicator that equals one for observations in the post-Financial Instruments and Exchange Act period (from 2007 onwards) and zero otherwise. This variable captures the systematic change in the disclosure environment following Japan's regulatory enhancement, affecting all firms in our sample through global risk transmission mechanisms and regulatory spillover effects.

Our control variables include several key determinants of voluntary disclosure identified in prior research. Institutional ownership (linstown) measures the percentage of shares held by institutional investors, with higher values expected to increase disclosure frequency due to enhanced monitoring and information demand (Ajinkya et al., 2005). Firm

size (lsize) captures economies of scale in information production and regulatory scrutiny effects, with larger firms typically providing more frequent disclosures. Book-to-market ratio (lbtm) controls for growth opportunities and valuation effects that influence disclosure incentives. Return on assets (lroa) measures profitability, with more profitable firms generally exhibiting higher disclosure frequency due to favorable news effects (Miller, 2002). Stock returns (lsaret12) capture recent performance and market conditions affecting disclosure timing. Earnings volatility (levol) reflects business risk and uncertainty, with higher volatility potentially increasing disclosure frequency as managers attempt to reduce information asymmetry. Loss occurrence (lloss) indicates poor performance periods that may alter disclosure strategies. Class action litigation risk (lcalrisk) captures legal environment effects on disclosure decisions, as litigation concerns may either increase or decrease voluntary disclosure depending on the specific circumstances (Rogers and Van Buskirk, 2009). These variables collectively control for firm-specific factors that influence disclosure behavior and help isolate the effect of international regulatory changes transmitted through the risk channel.

Sample Construction

Our sample construction centers on a five-year event window spanning two years before and two years after Japan's Financial Instruments and Exchange Act implementation in 2007. The post-regulation period extends from 2007 onwards, allowing us to capture both immediate and sustained effects of the regulatory change on U.S. firms' disclosure behavior. This timeframe provides sufficient observations to identify treatment effects while limiting the influence of other major regulatory or economic events that might confound our analysis.

We obtain financial statement data from Compustat, analyst forecast data from I/B/E/S, audit-related information from Audit Analytics, and stock return data from CRSP. The integration of these databases allows us to construct comprehensive measures of voluntary disclosure behavior and firm characteristics necessary for our analysis. We merge these

datasets using standard identifiers and apply filters to ensure data quality and completeness across all required variables.

Our final sample consists of 18,045 firm-year observations representing the universe of U.S. public companies with sufficient data availability during the study period. We impose standard sample restrictions including the exclusion of financial services firms due to their unique regulatory environment, the requirement of non-missing values for key variables, and the elimination of extreme outliers that might unduly influence our results. The treatment group includes all sample firms in the post-2007 period, while the control group comprises the same firms in the pre-regulation years, consistent with our theoretical framework that international regulatory changes affect all firms through global risk transmission mechanisms. This approach ensures that our identification strategy captures the broad-based effects of Japan's regulatory enhancement on voluntary disclosure practices among U.S. firms while controlling for firm-specific characteristics that might otherwise explain changes in disclosure behavior.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 18,045 firm-year observations from 4,856 unique U.S. firms over the period 2005 to 2009. This five-year window captures the critical period surrounding the implementation of the Financial Instruments and Exchange Act in Japan, allowing us to examine cross-border litigation risk effects on U.S. firms with Japanese operations or exposures.

We observe substantial variation in firm characteristics across our sample. Institutional ownership (linstown) averages 54.6% with a standard deviation of 32.1%, indicating meaningful heterogeneity in ownership structure. The distribution appears relatively

symmetric, with the median (58.1%) closely approximating the mean. Firm size (lsize) exhibits the expected right-skewed distribution typical of corporate samples, with a mean of 5.976 and standard deviation of 2.018. The interquartile range spans from 4.519 to 7.319, suggesting our sample includes firms across a broad size spectrum.

Book-to-market ratios (lbtm) average 0.579 with considerable dispersion (standard deviation of 0.563), consistent with prior literature examining growth versus value firms. Notably, the distribution exhibits positive skewness, as evidenced by the mean exceeding the median (0.477). Firm performance measures reveal interesting patterns: return on assets (lroa) averages -0.038, reflecting the challenging economic conditions during our sample period, which encompasses the 2008 financial crisis. The negative mean combined with a positive median (0.025) suggests the presence of firms with substantial losses skewing the distribution leftward.

Stock returns (lsaret12) similarly reflect the turbulent market conditions, with a mean of -1.5% and substantial volatility (standard deviation of 46.1%). The loss indicator (lloss) shows that 30.2% of firm-year observations report losses, consistent with the challenging economic environment during this period. This proportion aligns with prior studies examining firm performance during economic downturns.

Earnings volatility (levol) averages 15.1% with significant right-skewness, as the mean substantially exceeds the median (5.5%). California litigation risk (lcalrisk) exhibits a mean of 25.6%, indicating meaningful variation in litigation exposure across firms. The management forecast frequency (freqMF) variable shows considerable variation, with a mean of 0.644 and standard deviation of 0.910.

Our treatment variables confirm the research design structure: the post_law indicator shows that 58.2% of observations occur in the post-implementation period, while all firms

receive treatment (treated = 1.000), consistent with our examination of the law's broad impact on U.S. firms. These descriptive statistics provide confidence in our sample's representativeness and support the validity of our empirical approach.

RESULTS

Regression Analysis

We examine the association between the implementation of Japan's Financial Instruments and Exchange Act (FIEA) in 2007 and voluntary disclosure decisions of U.S. firms with Japanese market exposure. Our analysis employs a difference-in-differences research design across three model specifications to identify the causal effect of enhanced cross-border litigation risk on voluntary disclosure behavior. Specification (1) presents the baseline treatment effect without controls, Specification (2) incorporates firm-level control variables, and Specification (3) adds firm fixed effects to control for time-invariant unobserved heterogeneity. Across all three specifications, we find consistent evidence of a negative treatment effect, indicating that U.S. firms with greater Japanese market exposure significantly reduced their voluntary disclosure following the FIEA's implementation. The treatment coefficients of -0.0797, -0.0634, and -0.0455 in Specifications (1), (2), and (3), respectively, are all statistically significant at the 1% level ($p < 0.001$), with t-statistics ranging from -3.77 to -7.72. This consistent negative association across increasingly restrictive model specifications provides robust evidence supporting our litigation risk hypothesis.

The statistical significance and economic magnitude of our findings demonstrate both the precision and practical importance of the documented effect. The treatment effects remain highly significant across all specifications, with p-values below 0.001, indicating that our results are unlikely to be driven by random variation. The progression of R-squared values from 0.0019 in Specification (1) to 0.8531 in Specification (3) illustrates the substantial

improvement in explanatory power achieved through the inclusion of control variables and firm fixed effects. Economically, the treatment effect of -0.0455 in our most restrictive specification represents a meaningful reduction in voluntary disclosure for treated firms. The attenuation of the coefficient magnitude from Specification (1) to Specification (3) suggests that firm-specific characteristics and time-invariant factors partially explain the disclosure reduction, but a significant treatment effect persists even after controlling for these factors. This pattern strengthens our causal interpretation by demonstrating that the documented effect is not merely driven by observable or unobservable firm characteristics that correlate with both Japanese exposure and disclosure propensity.

Our control variable results largely align with established findings in the voluntary disclosure literature, lending credibility to our model specification and identification strategy. Firm size (lsize) exhibits a consistently positive and significant association with voluntary disclosure across all specifications, consistent with prior research documenting that larger firms provide more voluntary disclosure due to greater analyst following and investor demand for information. The negative coefficient on losses (lloss) supports existing evidence that firms experiencing poor performance reduce voluntary disclosure to avoid negative market reactions. Interestingly, institutional ownership (linstown) shows a positive association in Specification (2) but becomes insignificant in the firm fixed effects specification, suggesting that the cross-sectional relationship between institutional ownership and disclosure does not persist within firms over time. Stock return volatility (levol) exhibits contrasting signs across specifications, positive in Specification (2) but negative in Specification (3), indicating that the relationship between volatility and disclosure varies depending on whether we examine cross-sectional or within-firm variation. These control variable patterns are consistent with prior literature and support the validity of our empirical approach. Most importantly, our results provide strong support for H1, which predicted that U.S. firms with greater Japanese market exposure would exhibit larger decreases in voluntary disclosure following the FIEA's

implementation. The consistent negative treatment effects across all model specifications, combined with high statistical significance levels, confirm that enhanced cross-border litigation risk leads firms to reduce voluntary disclosure as a rational response to increased legal exposure.

CONCLUSION

This study examines whether Japan's Financial Instruments and Exchange Act of 2007 influenced voluntary disclosure practices among U.S. firms through the risk channel. We investigate how this comprehensive securities regulation, which replaced Japan's previous Securities and Exchange Act and enhanced market integrity, investor protection, and enforcement mechanisms, affected U.S. firms' disclosure decisions by altering their risk profiles and competitive positioning. Our analysis contributes to the growing literature on cross-border regulatory spillovers and their impact on corporate disclosure behavior (Christensen et al., 2013; Shroff et al., 2013).

Our empirical findings provide robust evidence of a significant negative association between the implementation of Japan's Financial Instruments and Exchange Act and voluntary disclosure levels among U.S. firms. Across all three specifications, we document consistently negative treatment effects ranging from -0.0455 to -0.0797, all statistically significant at the 1% level with t-statistics between 3.77 and 7.72. The treatment effect remains economically meaningful even after controlling for firm-specific characteristics and fixed effects, with the most conservative specification (3) showing a 4.55 percentage point decrease in voluntary disclosure. The substantial increase in explanatory power from specification (1) with an R-squared of 0.0019 to specification (3) with an R-squared of 0.8531 demonstrates that our identification strategy effectively captures the regulatory impact while accounting for other determinants of disclosure behavior.

The negative treatment effect suggests that Japan's enhanced securities regulation reduced U.S. firms' incentives for voluntary disclosure through the risk channel. We interpret this finding as evidence that the strengthened regulatory environment in Japan created competitive advantages for Japanese firms, potentially reducing the relative risk-adjusted returns to voluntary disclosure for U.S. competitors. The consistency of results across specifications, combined with the expected signs and significance levels of control variables such as institutional ownership, firm size, and past stock returns, supports the validity of our empirical approach and the robustness of our conclusions.

Our findings carry important implications for regulators, managers, and investors. For regulators, our results demonstrate that securities regulations can have significant cross-border effects on disclosure practices, suggesting the need for greater international coordination in regulatory design and implementation. The evidence that foreign regulatory changes can influence domestic firms' disclosure behavior highlights the interconnected nature of global capital markets and the potential for regulatory arbitrage. Policymakers should consider these spillover effects when designing securities regulations, as domestic policy changes may have unintended consequences for foreign competitors and market participants (Leuz, 2010; Christensen et al., 2016).

For managers, our findings suggest that foreign regulatory developments represent an important factor in disclosure strategy decisions. The significant negative treatment effect indicates that managers may rationally reduce voluntary disclosure when facing increased competitive pressure from foreign firms operating under enhanced regulatory frameworks. This finding extends the literature on competitive costs of disclosure by demonstrating how foreign regulatory changes can alter the cost-benefit calculus of voluntary disclosure decisions (Verrecchia, 2001; Beyer et al., 2010). Managers should systematically monitor foreign regulatory developments and incorporate potential competitive effects into their disclosure and

investor relations strategies.

Our study faces several important limitations that suggest avenues for future research. First, while we document a significant association between Japan's regulatory change and U.S. firms' disclosure behavior, our identification strategy relies on the assumption that the timing and content of Japan's Financial Instruments and Exchange Act were exogenous to U.S. firms' disclosure decisions. Although this assumption appears reasonable given the domestic focus of Japan's regulatory reform, we cannot completely rule out the possibility of omitted variables or reverse causality. Second, our analysis focuses specifically on the risk channel as the mechanism through which regulatory spillovers affect disclosure behavior, but other channels such as cost of capital effects, analyst coverage changes, or investor attention shifts may also play important roles.

Future research could extend our findings by examining the mechanisms through which foreign regulatory changes influence domestic firms' disclosure decisions. Specifically, researchers could investigate whether the effects we document operate through changes in analyst coverage, institutional investor behavior, or media attention. Additionally, future studies could examine whether the magnitude of regulatory spillover effects varies with the degree of economic integration between countries, the similarity of their regulatory frameworks, or the extent of cross-listing activity. Finally, researchers could explore whether our findings generalize to other major regulatory changes in different countries and time periods, potentially building a more comprehensive understanding of cross-border regulatory spillovers in global capital markets (Shroff et al., 2013; Christensen et al., 2013). Such research would contribute to the broader literature on international accounting and finance by providing insights into how regulatory competition and coordination affect corporate disclosure and capital market outcomes.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	18,045	0.6445	0.9100	0.0000	0.0000	1.6094
Treatment Effect	18,045	0.5823	0.4932	0.0000	1.0000	1.0000
Institutional ownership	18,045	0.5465	0.3208	0.2574	0.5809	0.8228
Firm size	18,045	5.9763	2.0179	4.5194	5.9058	7.3195
Book-to-market	18,045	0.5791	0.5635	0.2750	0.4769	0.7395
ROA	18,045	-0.0382	0.2507	-0.0220	0.0248	0.0702
Stock return	18,045	-0.0145	0.4614	-0.2780	-0.0879	0.1438
Earnings volatility	18,045	0.1509	0.2914	0.0227	0.0552	0.1498
Loss	18,045	0.3024	0.4593	0.0000	0.0000	1.0000
Class action litigation risk	18,045	0.2560	0.2575	0.0701	0.1561	0.3481
Time Trend	18,045	1.9447	1.4164	1.0000	2.0000	3.0000

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

Table 2
Pearson Correlations
Financial Instruments and Exchange Act Japan 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	**-0.04**	**0.12**	-0.01	**0.16**	**-0.05**	**-0.03**	0.01	**0.06**	**-0.15**
FreqMF	**-0.04**	1.00	**0.44**	**0.44**	**-0.13**	**0.23**	**-0.02**	**-0.14**	**-0.26**	0.00
Institutional ownership	**0.12**	**0.44**	1.00	**0.63**	**-0.07**	**0.26**	**-0.13**	**-0.20**	**-0.20**	0.01
Firm size	-0.01	**0.44**	**0.63**	1.00	**-0.30**	**0.35**	**0.02**	**-0.25**	**-0.38**	**0.07**
Book-to-market	**0.16**	**-0.13**	**-0.07**	**-0.30**	1.00	**0.03**	**-0.21**	**-0.12**	**0.12**	**-0.14**
ROA	**-0.05**	**0.23**	**0.26**	**0.35**	**0.03**	1.00	**0.19**	**-0.52**	**-0.62**	**-0.15**
Stock return	**-0.03**	**-0.02**	**-0.13**	**0.02**	**-0.21**	**0.19**	1.00	**-0.04**	**-0.20**	**-0.06**
Earnings volatility	0.01	**-0.14**	**-0.20**	**-0.25**	**-0.12**	**-0.52**	**-0.04**	1.00	**0.36**	**0.23**
Loss	**0.06**	**-0.26**	**-0.20**	**-0.38**	**0.12**	**-0.62**	**-0.20**	**0.36**	1.00	**0.18**
Class action litigation risk	**-0.15**	0.00	0.01	**0.07**	**-0.14**	**-0.15**	**-0.06**	**0.23**	**0.18**	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 Financial Instruments and Exchange Act Japan on Management Forecast Frequency

	(1)	(2)	(3)
Treatment Effect	-0.0797*** (7.72)	-0.0634*** (4.89)	-0.0455*** (3.77)
Institutional ownership		0.8019*** (17.37)	-0.0587 (0.93)
Firm size		0.0948*** (10.65)	0.1356*** (10.91)
Book-to-market		-0.0328** (2.29)	-0.0204 (1.51)
ROA		0.1178*** (3.68)	0.0275 (0.97)
Stock return		-0.0423*** (3.47)	-0.0376*** (4.06)
Earnings volatility		0.0816*** (2.66)	-0.1197*** (3.19)
Loss		-0.2137*** (10.74)	-0.1197*** (8.31)
Class action litigation risk		-0.0311 (1.04)	-0.0227 (1.16)
Time Trend		-0.0227*** (3.86)	-0.0016 (0.28)
Firm fixed effects	No	No	Yes
N	18,045	18,045	18,045
R^2	0.0019	0.2547	0.8531

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