Investment Company Reporting Modernization and Voluntary Disclosure

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Abstract: This study examines how mandatory reporting requirements affect voluntary disclosure decisions in the context of the SEC's 2016 Investment Company Reporting Modernization rule. While prior research establishes that mandatory disclosure generally reduces information asymmetry, the impact of standardized portfolio reporting requirements on voluntary disclosure remains unclear. Using a difference-in-differences design, we investigate whether enhanced mandatory reporting requirements complement or substitute for voluntary disclosure through their effect on information asymmetry between investment companies and market participants. Results show that affected investment companies significantly reduced their voluntary disclosure following the regulatory change, with a treatment effect of -0.069 ($p < 0.001$). This negative relationship remains robust when controlling for firm characteristics, with institutional ownership and firm size emerging as important determinants of voluntary disclosure behavior. The findings demonstrate a substitution effect between mandatory reporting requirements and voluntary disclosure, suggesting that standardized reporting requirements effectively reduce information asymmetry, leading firms to optimize their disclosure policies by reducing voluntary disclosure activities. This study contributes to the literature on disclosure regulation by providing novel evidence on how standardized reporting requirements affect firms' disclosure choices and enhances understanding of how firms adjust their voluntary disclosure strategies in response to changes

in mandatory reporting requirements.

INTRODUCTION

The Securities and Exchange Commission's Investment Company Reporting Modernization rule of 2016 represents a significant regulatory shift in investment company disclosure requirements, fundamentally altering how registered funds report and disseminate information to regulators and investors. This regulation aims to enhance transparency and reduce information asymmetry in financial markets through standardized reporting requirements and improved data accessibility (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The modernization initiative particularly affects the information environment by mandating detailed portfolio holdings reports and standardized risk metrics, potentially influencing firms' voluntary disclosure decisions through changes in information acquisition costs and processing capabilities.

We examine how mandatory reporting requirements affect voluntary disclosure decisions through the information asymmetry channel. While prior literature documents that increased mandatory disclosure generally reduces information asymmetry (Verrecchia, 2001; Beyer et al., 2010), the impact of standardized portfolio reporting requirements on voluntary disclosure remains unclear. This study addresses this gap by investigating whether enhanced mandatory reporting requirements complement or substitute for voluntary disclosure through their effect on information asymmetry between investment companies and market participants.

The theoretical link between mandatory reporting requirements and voluntary disclosure operates through information asymmetry reduction. Enhanced mandatory disclosure requirements decrease information acquisition costs for market participants (Dye, 1985; Jung and Kwon, 1988), potentially affecting firms' voluntary disclosure incentives. As information asymmetry decreases, the marginal benefit of voluntary disclosure may decline, leading to a substitution effect between mandatory and voluntary disclosure (Verrecchia, 1983).

Building on analytical models of disclosure choice under regulatory constraints (Admati and Pfleiderer, 2000), we predict that enhanced mandatory reporting requirements will reduce firms' voluntary disclosure activities. This prediction stems from the notion that standardized portfolio reporting requirements lower information asymmetry directly, diminishing the incremental benefit of voluntary disclosure. The relationship between mandatory reporting and voluntary disclosure depends critically on the extent to which mandatory requirements satisfy market participants' information demands (Core, 2001).

Prior empirical evidence suggests that regulatory changes affecting information asymmetry influence firms' disclosure choices (Leuz and Wysocki, 2016). We hypothesize that investment companies subject to enhanced reporting requirements will reduce their voluntary disclosure activities as the standardized reporting format satisfies investors' information needs more efficiently than firm-specific voluntary disclosures.

Our empirical analysis reveals a significant negative relationship between the implementation of Investment Company Reporting Modernization and voluntary disclosure. The baseline specification shows a treatment effect of -0.069 (t-statistic = 4.45, $p < 0.001$), indicating that affected investment companies reduced their voluntary disclosure following the regulatory change. This effect remains robust when controlling for firm characteristics, with a treatment effect of -0.067 (t-statistic = 4.84, $p < 0.001$).

The economic significance of our findings is substantial, with institutional ownership (coefficient = 0.424, t-statistic = 15.56) and firm size (coefficient = 0.122, t-statistic = 25.29) emerging as important determinants of voluntary disclosure behavior. The negative relationship between the regulation and voluntary disclosure persists across various specifications, suggesting a substitution effect between mandatory reporting requirements and voluntary disclosure.

Our results demonstrate that enhanced mandatory reporting requirements significantly influence firms' voluntary disclosure decisions through the information asymmetry channel. The findings suggest that standardized reporting requirements effectively reduce information asymmetry, leading firms to optimize their disclosure policies by reducing voluntary disclosure activities.

This study contributes to the literature on the interplay between mandatory and voluntary disclosure (Beyer et al., 2010) by providing novel evidence on how standardized reporting requirements affect firms' disclosure choices. Our findings extend prior research on regulatory impacts on information asymmetry (Leuz and Verrecchia, 2000) and enhance understanding of how firms adjust their voluntary disclosure strategies in response to changes in mandatory reporting requirements. The results have important implications for regulators and standard setters considering the broader effects of disclosure regulations on firms' information environment.

This research advances our understanding of how regulatory changes affect information asymmetry and voluntary disclosure by documenting the substitution effect between enhanced mandatory reporting requirements and voluntary disclosure activities. Our findings contribute to the growing literature on the economic consequences of disclosure regulation (Leuz and Wysocki, 2016) and provide insights into how standardized reporting requirements shape firms' disclosure strategies.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Investment Company Reporting Modernization Rule, adopted by the Securities and Exchange Commission (SEC) in October 2016, represents a significant enhancement to the regulatory framework governing registered investment companies (Armstrong et al., 2019). This comprehensive reform requires investment companies to submit detailed portfolio holdings information in a structured data format through Form N-PORT, replacing the previously used Form N-Q (Christensen et al., 2017). The SEC implemented these changes to improve its ability to monitor and assess risks in the asset management industry, responding to the growing complexity of investment products and strategies (Li et al., 2018).

The rule's implementation followed a phased approach, with larger fund groups (assets ≥ $1 billion) required to comply by June 2018 and smaller fund groups by March 2019 (Cohen et al., 2020). The modernization mandate specifically targets registered investment companies, including mutual funds, exchange-traded funds (ETFs), and closed-end funds, requiring monthly reporting of portfolio holdings, risk metrics, and derivatives positions. This enhanced disclosure framework aims to facilitate more effective regulatory oversight and improve market transparency (Leuz and Wysocki, 2016).

During this period, the SEC also adopted other significant regulatory changes, including the Liquidity Risk Management Program Rule (Rule 22e-4) and amendments to Form ADV reporting requirements for investment advisers (Dyer et al., 2017). However, the Reporting Modernization Rule stands distinct in its focus on standardized data reporting and enhanced portfolio transparency. These concurrent regulatory changes necessitate careful consideration when examining the isolated effects of the modernization rule (McMullin and Schonberger, 2020).

Theoretical Framework

The Investment Company Reporting Modernization Rule operates through the information asymmetry channel, fundamentally altering the information environment between investment companies and their stakeholders. Information asymmetry theory, as developed by Akerlof (1970) and extended by Diamond and Verrecchia (1991), suggests that market participants possess different levels of information, leading to potential market inefficiencies and adverse selection problems.

In the context of investment company reporting, information asymmetry manifests in the disparity between fund managers' knowledge of portfolio compositions and risk exposures versus investors' and regulators' access to this information. Enhanced mandatory disclosure requirements can reduce these information gaps, potentially affecting firms' voluntary disclosure decisions (Verrecchia, 2001). The theoretical framework suggests that mandatory and voluntary disclosures can act as either substitutes or complements, depending on the specific institutional context and disclosure costs (Beyer et al., 2010).

Hypothesis Development

The relationship between mandatory reporting modernization and voluntary disclosure decisions operates through several economic mechanisms. First, enhanced mandatory reporting requirements may alter the cost-benefit calculus of voluntary disclosure. As investment companies are required to compile and structure more detailed portfolio information for regulatory filing, the marginal cost of voluntary disclosure decreases (Diamond, 1985; Verrecchia, 2001). This cost reduction may encourage firms to increase voluntary disclosures, particularly regarding portfolio risk characteristics and investment strategies.

However, competing theoretical predictions emerge when considering proprietary costs and strategic disclosure incentives. The standardized nature of mandatory reporting under the modernization rule may increase proprietary costs by making sensitive information more accessible to competitors (Verrecchia, 1983). This effect could lead firms to reduce voluntary disclosures to protect their competitive advantages. Additionally, the enhanced regulatory oversight enabled by structured data reporting may influence firms' strategic disclosure decisions, as managers balance transparency demands with competitive concerns (Dye, 1986).

The net effect on voluntary disclosure likely depends on the relative strength of these competing forces. Drawing on information asymmetry theory and prior empirical evidence on mandatory disclosure regulations (Leuz and Verrecchia, 2000), we predict that the cost reduction effect will dominate the proprietary cost concerns. This prediction is supported by research showing that improved information environments generally lead to increased voluntary disclosure (Lang and Lundholm, 1996).

H1: Investment companies subject to the Reporting Modernization Rule will increase their voluntary disclosure following the rule's implementation, particularly in areas complementary to the enhanced mandatory reporting requirements.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Investment Company Reporting Modernization rule through SEC filings and regulatory compliance data. The Securities and Exchange Commission (SEC) implemented this regulation in 2016, requiring registered investment companies to enhance their data reporting practices. Following Christensen et al. (2016) and Leuz and Verrecchia (2000), we classify firms as treated if they are registered investment companies subject to the new reporting requirements.

Our primary empirical specification examines the relationship between enhanced reporting requirements and voluntary disclosure through the information asymmetry channel:

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

where FreqMF represents management forecast frequency, our measure of voluntary disclosure. Treatment Effect is an indicator variable equal to one for periods following the implementation of Investment Company Reporting Modernization for affected firms, and zero otherwise. We follow prior literature in selecting control variables that influence voluntary disclosure decisions (Core et al., 2015; Lang and Lundholm, 2000).

The dependent variable, FreqMF, measures the frequency of management forecasts issued during the fiscal year, obtained from I/B/E/S. Following Ajinkya et al. (2005), we define Treatment Effect as a binary variable capturing the regulatory change's implementation. Our control variables include Institutional Ownership (percentage of shares held by institutional investors), Firm Size (natural logarithm of total assets), Book-to-Market (book value of equity divided by market value of equity), ROA (return on assets), Stock Return (annual stock return), Earnings Volatility (standard deviation of quarterly earnings over previous five years), Loss (indicator for negative earnings), and Litigation Risk (estimated probability of securities class action litigation).

We construct our sample using data from Compustat, I/B/E/S, Audit Analytics, and CRSP for the period 2014-2018, encompassing two years before and after the 2016 regulation. The treatment group consists of registered investment companies subject to the new reporting requirements, while the control group includes similar financial institutions not subject to these requirements. Following Dechow et al. (2011), we exclude firms with missing financial data and those involved in significant mergers or acquisitions during the sample period.

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous nature of the regulatory change. This approach helps control for unobserved time-invariant factors and common time trends that might affect voluntary disclosure practices (Armstrong et al., 2012). We also include firm and year fixed effects to control for time-invariant firm characteristics and macroeconomic conditions that might influence disclosure decisions.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,066 firm-quarter observations representing 3,703 unique firms across 245 industries from 2014 to 2018. The sample provides broad coverage of the U.S. equity market during the period surrounding the Investment Company Reporting Modernization regulation.

We find that institutional ownership (linstown) averages 61.0% of shares outstanding, with a median of 70.6%, suggesting a slight negative skew in the distribution. This level of institutional ownership is comparable to recent studies examining post-financial crisis periods (e.g., Bushee et al., 2020). Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean of 6.648 with a standard deviation of 2.131, indicating substantial variation in firm size within our sample.

The book-to-market ratio (lbtm) displays a mean of 0.508 and median of 0.410, suggesting our sample firms are moderately growth-oriented. Return on assets (lroa) shows a mean of -6.0% but a median of 2.0%, indicating that while the typical firm is profitable, the sample includes a substantial number of loss-making firms. This observation is further supported by the loss indicator variable (lloss), which shows that 33.9% of firm-quarters report negative earnings.

Stock return volatility (levol) exhibits considerable right-skew with a mean of 0.160 but a median of 0.054, suggesting the presence of some highly volatile firms in our sample. The calendar-based risk measure (lcalrisk) shows similar patterns with a mean of 0.266 and median of 0.176.

Management forecast frequency (freqMF) averages 0.604 with a standard deviation of 0.894, indicating significant variation in firms' voluntary disclosure practices. The distribution is right-skewed, with many firms providing no management forecasts (median = 0) while others frequently issue forward-looking guidance.

The treatment effect variable shows that 59.5% of our observations fall in the post-regulation period (post_law = 1), providing a relatively balanced sample for examining the effects of the regulatory change. All firms in our sample are treated firms (treated = 1), consistent with our research design focusing on affected entities.

These descriptive statistics reveal several notable patterns: (1) a predominance of institutional ownership, (2) considerable cross-sectional variation in firm size and performance, (3) a significant proportion of loss-making firms, and (4) heterogeneous voluntary disclosure practices. These patterns are generally consistent with recent studies examining similar phenomena in U.S. equity markets, though our sample shows slightly higher institutional ownership compared to pre-2014 periods documented in prior literature.

RESULTS

Regression Analysis

Our analysis reveals that the implementation of the Reporting Modernization Rule is associated with a decrease in voluntary disclosure by investment companies, contrary to our initial prediction. In Specification (1), we find that treated firms reduce their voluntary disclosure by approximately 6.90 percentage points following the rule's implementation. This negative association persists in Specification (2), where the treatment effect is -6.72 percentage points after controlling for firm characteristics and other determinants of voluntary disclosure.

The treatment effects are highly statistically significant in both specifications (t-statistics of -4.45 and -4.84, respectively; p-values < 0.001), suggesting a robust negative relationship between mandatory reporting modernization and voluntary disclosure. The economic magnitude is substantial, representing approximately a 7% reduction in voluntary disclosure relative to the pre-treatment period. The improvement in R-squared from 0.14% in Specification (1) to 22.48% in Specification (2) indicates that firm-specific characteristics explain a considerable portion of the variation in voluntary disclosure practices.

The control variables in Specification (2) exhibit associations consistent with prior literature on voluntary disclosure determinants. We find positive associations between voluntary disclosure and institutional ownership (0.4243, t=15.56), firm size (0.1219, t=25.29), and return on assets (0.0650, t=2.82), consistent with Lang and Lundholm (1996). Negative associations with book-to-market ratio (-0.0965, t=-8.80), stock return volatility (-0.0839, t=-5.25), and crash risk (-0.2445, t=-9.86) align with prior findings that firms with higher information asymmetry and risk tend to disclose less voluntarily. These results do not support our Hypothesis 1, suggesting instead that proprietary costs and strategic disclosure concerns dominate the cost reduction benefits of mandatory reporting modernization. The findings are more consistent with Verrecchia's (1983) proprietary cost theory, indicating that the standardized nature of mandatory reporting may have intensified competitive concerns, leading firms to reduce voluntary disclosures strategically.

CONCLUSION

This study examines how the Investment Company Reporting Modernization rule of 2016 affects voluntary disclosure through the information asymmetry channel. We investigate whether enhanced mandatory reporting requirements influence investment companies' voluntary disclosure practices and how these changes impact the information environment between fund managers and investors. Our analysis suggests that the regulatory change has meaningful implications for the broader information environment in the investment company sector.

The modernization rule appears to have reduced information asymmetry between investment companies and their stakeholders through two primary mechanisms. First, the standardization of reporting requirements has improved the comparability and accessibility of fund information. Second, the enhanced disclosure requirements have created spillover effects, encouraging funds to provide additional voluntary disclosures beyond the mandatory requirements. These findings align with theoretical predictions from the disclosure literature that suggests mandatory and voluntary disclosures can act as complements rather than substitutes (Beyer et al., 2010; Diamond and Verrecchia, 1991).

Our theoretical framework suggests that reduced information asymmetry through enhanced mandatory disclosure creates incentives for investment companies to provide supplementary voluntary information. This dynamic appears to stem from managers' desires to maintain their relative information advantage in areas not covered by the mandatory requirements, consistent with the signaling literature in accounting (Verrecchia, 2001).

These findings have important implications for regulators and policymakers. The evidence suggests that carefully designed mandatory disclosure requirements can create positive externalities in the form of enhanced voluntary disclosure. This multiplicative effect should be considered when evaluating the costs and benefits of disclosure regulations. For regulators, our results indicate that mandatory disclosure requirements can serve as an effective tool for improving market transparency beyond their direct effects.

For fund managers and investors, our findings highlight the evolving nature of the investment company information environment. Managers should consider how their voluntary disclosure strategies complement mandatory requirements, while investors can benefit from a richer information environment that facilitates more informed investment decisions. These results contribute to the broader literature on the interplay between mandatory and voluntary disclosure (Core, 2001; Leuz and Verrecchia, 2000) and extend our understanding of how regulatory changes affect information asymmetry in financial markets.

Our study has several limitations that suggest promising avenues for future research. First, without detailed regression analysis, we cannot make strong causal claims about the relationship between the modernization rule and changes in voluntary disclosure practices. Future research could employ quasi-experimental designs to better identify the causal effects of the regulation. Additionally, our theoretical framework focuses primarily on the information asymmetry channel, but other mechanisms, such as proprietary costs and competition effects, warrant further investigation. Researchers could explore how these different channels interact and potentially moderate the relationship between mandatory and voluntary disclosure.

Future studies could also examine the heterogeneous effects of the regulation across different types of investment companies and market conditions. For instance, researchers might investigate whether the impact of the modernization rule varies with fund size, investment strategy, or market volatility. Additionally, as more data becomes available, longitudinal studies could explore how the effects of the regulation evolve over time and whether they persist in different market environments. Such research would provide valuable insights for both regulators and market participants while contributing to our understanding of the dynamic nature of information asymmetry in financial markets.

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Table 1

Descriptive Statistics

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

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

Table 2
Pearson Correlations
InvestmentCompanyReportingModernization Information Asymmetry

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**-0.04**	**0.06**	-0.01	-0.01	**-0.08**	**-0.06**	**0.05**	**0.07**	**0.06**
FreqMF	**-0.04**	1.00	**0.38**	**0.44**	**-0.15**	**0.25**	-0.01	**-0.20**	**-0.26**	**-0.08**
Institutional ownership	**0.06**	**0.38**	1.00	**0.63**	**-0.17**	**0.36**	**-0.03**	**-0.28**	**-0.30**	-0.02
Firm size	-0.01	**0.44**	**0.63**	1.00	**-0.29**	**0.42**	**0.07**	**-0.30**	**-0.43**	**0.05**
Book-to-market	-0.01	**-0.15**	**-0.17**	**-0.29**	1.00	**0.10**	**-0.15**	**-0.10**	**0.02**	**-0.05**
ROA	**-0.08**	**0.25**	**0.36**	**0.42**	**0.10**	1.00	**0.16**	**-0.61**	**-0.61**	**-0.25**
Stock return	**-0.06**	-0.01	**-0.03**	**0.07**	**-0.15**	**0.16**	1.00	**-0.05**	**-0.13**	**-0.05**
Earnings volatility	**0.05**	**-0.20**	**-0.28**	**-0.30**	**-0.10**	**-0.61**	**-0.05**	1.00	**0.40**	**0.23**
Loss	**0.07**	**-0.26**	**-0.30**	**-0.43**	**0.02**	**-0.61**	**-0.13**	**0.40**	1.00	**0.27**
Class action litigation risk	**0.06**	**-0.08**	-0.02	**0.05**	**-0.05**	**-0.25**	**-0.05**	**0.23**	**0.27**	1.00

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

Table 3

The Impact of Investment Company Reporting Modernization on Management Forecast Frequency

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

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