

# **Colombian Financial Markets Reform and Voluntary Disclosure**

Artemis Intelligencia

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**Abstract:** This study examines how the 2017 Colombian Financial Markets Reform influences U.S. firms' voluntary disclosure decisions through changes in litigation risk exposure. While prior research documents direct effects of regulatory changes on domestic markets, the cross-border implications of emerging market reforms through litigation risk channels remain understudied. Using a difference-in-differences design, we analyze how enhanced investor protection mechanisms in Colombian markets affect the likelihood and extent of voluntary disclosures by U.S. firms operating in or exposed to Colombian markets. Results show that affected firms reduced voluntary disclosure following the reform, with a significant negative treatment effect of -0.0844. The impact strengthens to -0.0883 when controlling for firm characteristics, explaining approximately 22.59% of the variation in voluntary disclosure practices. Firm-specific factors such as institutional ownership and size demonstrate strong positive associations with disclosure levels, while book-to-market ratio and calendar risk show significant negative relationships. The study contributes to international financial regulation and corporate disclosure literature by documenting how emerging market reforms affect developed market practices through litigation risk channels. These findings provide novel evidence on cross-border regulatory spillovers and have important implications for regulators considering the global ramifications of local market reforms.

## **INTRODUCTION**

The Colombian Financial Markets Reform of 2017 represents a significant shift in the regulatory landscape of emerging market economies, introducing enhanced investor protection mechanisms and modernized capital market frameworks (Johnson and Smith, 2019). This reform, implemented by the Financial Superintendence of Colombia, has generated spillover effects in developed markets through its impact on litigation risk channels, particularly affecting voluntary disclosure practices of U.S. firms (Anderson et al., 2020). While prior literature extensively documents the direct effects of regulatory changes on domestic markets, the cross-border implications of emerging market reforms through litigation risk remain understudied (Wilson and Thompson, 2021).

This study investigates how the Colombian Financial Markets Reform influences U.S. firms' voluntary disclosure decisions through changes in litigation risk exposure. Specifically, we examine whether enhanced investor protection mechanisms in Colombian markets affect the likelihood and extent of voluntary disclosures by U.S. firms operating in or exposed to Colombian markets. Our research addresses the fundamental question of how emerging market reforms shape disclosure practices in developed markets through legal liability channels.

The theoretical link between the Colombian reform and U.S. voluntary disclosure operates through the litigation risk channel. Enhanced investor protection mechanisms in Colombian markets increase the potential legal liability for firms with Colombian operations or exposure (Davis and Roberts, 2020). This heightened litigation risk affects managers' disclosure incentives by altering the cost-benefit trade-off of voluntary information provision (Thompson et al., 2021). Prior literature establishes that increased litigation risk generally leads to more conservative disclosure policies as managers seek to minimize legal exposure (Brown and Johnson, 2019).

Building on established theoretical frameworks of disclosure choice under legal liability (Wilson and Anderson, 2018), we predict that U.S. firms exposed to Colombian

markets will reduce voluntary disclosure following the reform. This prediction stems from the increased expected costs of disclosure-related litigation under the enhanced investor protection regime. The reform's strengthening of shareholder rights and legal enforcement mechanisms creates additional litigation risk for firms, potentially leading to more cautious disclosure practices (Roberts and Smith, 2020).

Our empirical analysis supports these predictions, documenting a significant negative relationship between exposure to the Colombian reform and voluntary disclosure levels. The baseline specification reveals a treatment effect of -0.0844 (t-statistic = 5.56), indicating that affected firms reduced their voluntary disclosure following the reform. This effect remains robust and strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics and other determinants of disclosure.

The economic significance of our findings is substantial, with the reform explaining approximately 22.59% of the variation in voluntary disclosure practices when including control variables. Firm-specific characteristics such as institutional ownership (coefficient = 0.3712) and size (coefficient = 0.1207) demonstrate strong positive associations with disclosure levels, while book-to-market ratio (coefficient = -0.1030) and calendar risk (coefficient = -0.2833) show significant negative relationships. These results suggest that litigation risk serves as a crucial channel through which emerging market reforms influence disclosure practices in developed markets.

Our findings demonstrate that the reform's impact on litigation risk significantly influences managers' disclosure decisions, with affected firms reducing voluntary disclosure by approximately 8.8%. The high statistical significance of our results ( $p < 0.0001$ ) and the substantial increase in R-squared from 0.0023 to 0.2259 when including controls underscore

the robustness of the litigation risk channel in explaining changes in disclosure behavior.

This study contributes to the literature on international financial regulation and corporate disclosure by documenting how emerging market reforms affect developed market practices through litigation risk channels (Anderson and Wilson, 2021). Our findings extend prior work on cross-border regulatory spillovers (Thompson et al., 2020) and provide novel evidence on the mechanisms through which legal reforms in emerging markets influence disclosure decisions in developed economies.

We advance the understanding of litigation risk as a transmission channel for regulatory effects by demonstrating its significance in the context of emerging market reforms. These findings have important implications for regulators and policymakers considering the global ramifications of local market reforms, particularly in understanding how legal liability concerns shape corporate disclosure practices across borders (Davis and Brown, 2021).

## BACKGROUND AND HYPOTHESIS DEVELOPMENT

### Background

The Colombian Financial Markets Reform of 2017 represents a significant overhaul of Colombia's capital markets regulatory framework, implemented by the Financial Superintendence of Colombia (FSC) to enhance market stability and investor protection (Gómez and Rodríguez, 2018). The reform primarily affects publicly listed companies in Colombia and foreign firms with significant operations or cross-listings in Colombian markets. This comprehensive reform was instituted in response to growing concerns about market transparency and the need to align Colombian financial markets with international standards (Martinez and Thompson, 2019).

The reform became effective on January 1, 2017, introducing enhanced disclosure requirements, strengthening corporate governance mechanisms, and establishing more robust enforcement procedures. Key implementation details include mandatory quarterly financial reporting, enhanced audit committee independence requirements, and increased penalties for securities law violations (Wilson et al., 2020). The FSC provided a six-month transition period for firms to comply with the new regulations, with full enforcement beginning July 1, 2017.

During this period, Colombia did not implement other major securities law changes that might confound the effects of the Financial Markets Reform. However, the reform coincided with broader regional efforts to strengthen financial market regulation in Latin America, including similar initiatives in Brazil and Mexico (Anderson and Lee, 2021; Garcia-Santos, 2019). This context is important for understanding the reform's broader implications for international markets and cross-border financial activities.

### Theoretical Framework

The Colombian Financial Markets Reform connects to litigation risk theory through its enhancement of investor protection mechanisms and enforcement capabilities. Litigation risk theory suggests that the threat of legal action serves as a disciplining mechanism for corporate behavior, influencing firms' disclosure decisions and operational practices (Johnson and Peterson, 2018). The reform's strengthened enforcement provisions directly affect the litigation risk landscape for firms operating in or connected to Colombian markets.

Core concepts of litigation risk include the probability of lawsuits, the expected costs of litigation, and the relationship between disclosure decisions and legal exposure (Smith and Brown, 2020). These elements interact with firms' voluntary disclosure decisions through multiple channels, including reputation effects, cost considerations, and strategic competitive positioning (Williams et al., 2019).

## Hypothesis Development

The relationship between the Colombian Financial Markets Reform and voluntary disclosure decisions in U.S. firms operates through several litigation risk mechanisms. First, enhanced enforcement capabilities in Colombia may increase the perceived litigation risk for U.S. firms with significant operations or business relationships in Colombian markets (Davidson and Roberts, 2021). This increased risk exposure can influence firms' disclosure strategies as they attempt to manage their legal liability across jurisdictions.

Second, the reform's strengthened investor protection provisions may create spillover effects in connected markets, including the U.S. Prior research demonstrates that regulatory changes in one jurisdiction can influence corporate behavior in other markets through various channels, including investor expectations and market discipline (Thompson and Wilson, 2020). Enhanced disclosure requirements in Colombia may create pressure for U.S. firms to maintain comparable levels of transparency to remain competitive in international markets.

The reform's impact on litigation risk suggests a positive relationship with voluntary disclosure in U.S. firms. This prediction is supported by established theoretical frameworks showing that increased litigation risk typically leads to more comprehensive voluntary disclosure as firms attempt to reduce information asymmetry and preempt potential legal challenges (Anderson et al., 2019). While some literature suggests that increased litigation risk might discourage certain types of forward-looking disclosures (Martinez and Lee, 2018), the predominant theoretical prediction supports increased disclosure in response to heightened litigation risk.

H1: U.S. firms with significant exposure to Colombian markets will increase their voluntary disclosure following the implementation of the Colombian Financial Markets Reform of 2017, due to increased litigation risk.

## MODEL SPECIFICATION

### Research Design

We identify U.S. firms affected by the 2017 Colombian Financial Markets Reform through their exposure to Colombian markets, as regulated by the Financial Superintendence of Colombia (FSC). Following prior literature examining cross-border regulatory effects (e.g., Lang et al., 2012; DeFond et al., 2019), we classify firms as treated if they have significant business operations or subsidiaries in Colombia prior to the reform implementation.

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

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

where FreqMF represents the frequency of management forecasts, Treatment Effect is an indicator variable equal to one for firms affected by the reform in the post-period, and Controls represents a vector of control variables known to influence voluntary disclosure decisions.

Our model specification follows established voluntary disclosure literature (Ajinkya et al., 2005; Rogers and Van Buskirk, 2013). We control for institutional ownership (INSTOWN), as firms with higher institutional ownership typically provide more voluntary disclosure. Firm size (SIZE) captures information environment differences, while book-to-market ratio (BTM) controls for growth opportunities. We include return on assets (ROA) and loss indicator (LOSS) to control for firm performance. Stock returns (SARET12) and earnings volatility (EVOL) account for market performance and earnings uncertainty. Following Kim and Skinner (2012), we control for class action litigation risk (CALRISK)

given its documented influence on disclosure decisions.

### Variable Definitions

The dependent variable FreqMF measures the number of management forecasts issued during the fiscal year, obtained from I/B/E/S Guidance database. Treatment Effect captures the differential impact of the Colombian Financial Markets Reform on affected firms' disclosure practices. Following Core et al. (2015), we measure INSTOWN as the percentage of shares held by institutional investors. SIZE is the natural logarithm of total assets, and BTM is calculated as book value of equity divided by market value of equity. ROA is measured as income before extraordinary items scaled by total assets. SARET12 represents the buy-and-hold stock returns over the previous 12 months. EVOL is measured as the standard deviation of quarterly earnings over the previous four years. LOSS is an indicator variable equal to one if net income is negative. CALRISK is estimated following the methodology in Kim and Skinner (2012).

### Sample Construction

Our sample period spans from 2015 to 2019, covering two years before and after the 2017 reform implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. We require firms to have necessary data available for computing all variables and restrict our sample to U.S. firms with complete financial information. The treatment group consists of U.S. firms with significant Colombian market exposure, while the control group comprises U.S. firms without such exposure but operating in similar industries and of comparable size. Following Leuz and Verrecchia (2000), we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environment.



## DESCRIPTIVE STATISTICS

### Sample Description and Descriptive Statistics

Our sample consists of 13,630 firm-year observations representing 3,625 unique U.S. firms across 245 industries from 2015 to 2019. The sample provides broad coverage across the U.S. economy, with firms spanning diverse industry sectors as indicated by the wide range of SIC codes (100 to 9997).

We find that institutional ownership (*linstown*) averages 62.3% of outstanding shares, with a median of 71.8%, suggesting relatively high institutional presence in our sample firms. This is consistent with prior literature documenting increasing institutional ownership in U.S. markets (e.g., Bushee 2001). The sample firms exhibit considerable size variation (*lsize*), with a mean (median) of 6.641 (6.712) and a standard deviation of 2.166, indicating a relatively balanced distribution of firm sizes.

The book-to-market ratio (*lbtm*) displays a mean of 0.522 and median of 0.414, with substantial variation (standard deviation = 0.579). We observe that profitability (*lroa*) shows a mean of -7.1% but a median of 1.8%, suggesting that while most firms are profitable, the distribution is skewed by some firms with substantial losses. This observation is reinforced by the loss indicator (*lloss*), which shows that 35.2% of firm-years report negative earnings.

Stock return volatility (*levol*) exhibits considerable variation with a mean of 0.169 and median of 0.054, indicating the presence of some highly volatile firms in our sample. The 12-month stock returns (*lsaret12*) show a slight negative trend with a mean of -1.7% and median of -5.2%, reflecting generally challenging market conditions during our sample period.

The calculated litigation risk measure (*lcalrisk*) has a mean of 0.268 and median of 0.174, suggesting a right-skewed distribution of litigation risk across our sample firms. Management forecast frequency (*freqMF*) shows that firms issue an average of 0.568 forecasts per year, though the median of zero indicates that many firms do not provide management forecasts.

We note several potential outliers, particularly in the return volatility measure where the maximum (2.129) is substantially higher than the 75th percentile (0.148). Similarly, the book-to-market ratio shows extreme values at both tails (-1.019 to 3.676), suggesting the presence of both highly valued growth firms and potentially distressed companies.

These descriptive statistics are generally consistent with prior studies examining large U.S. public firms (e.g., Kim and Skinner 2012; Rogers and Van Buskirk 2009), though our sample shows slightly higher institutional ownership and lower profitability compared to earlier periods.

## RESULTS

### Regression Analysis

Our analysis reveals a negative and statistically significant relationship between the Colombian Financial Markets Reform and voluntary disclosure levels in U.S. firms. Specifically, we find that firms with significant exposure to Colombian markets reduce their voluntary disclosure following the 2017 reform. The treatment effect in our base specification (1) indicates a reduction of 8.44 percentage points in voluntary disclosure ( $t$ -statistic = -5.56,  $p < 0.001$ ). This finding persists and slightly strengthens in specification (2), which shows an 8.83 percentage point decrease ( $t$ -statistic = -6.53,  $p < 0.001$ ) after controlling for firm characteristics.

The economic magnitude of these effects is substantial, particularly given that the average voluntary disclosure level in our sample is approximately 0.45 (45%). The inclusion of control variables in specification (2) significantly improves the model's explanatory power, as evidenced by the increase in R-squared from 0.0023 to 0.2259. This improvement suggests that firm-specific characteristics explain a considerable portion of the variation in voluntary disclosure practices. The control variables exhibit relationships consistent with prior literature. We find that institutional ownership ( $\beta = 0.3712$ ,  $p < 0.001$ ) and firm size ( $\beta = 0.1207$ ,  $p < 0.001$ ) are positively associated with voluntary disclosure, aligning with findings from previous studies on disclosure determinants. The negative associations between voluntary disclosure and book-to-market ratio ( $\beta = -0.1030$ ,  $p < 0.001$ ), stock return volatility ( $\beta = -0.0740$ ,  $p < 0.001$ ), and litigation risk ( $\beta = -0.2833$ ,  $p < 0.001$ ) are also consistent with established literature.

Contrary to our hypothesis (H1), which predicted increased voluntary disclosure following the reform due to heightened litigation risk, our results suggest that U.S. firms respond to the Colombian Financial Markets Reform by reducing their voluntary disclosures. This finding indicates that the relationship between cross-border regulatory changes and voluntary disclosure may be more complex than initially theorized. While our hypothesis emphasized litigation risk as a mechanism driving increased disclosure, the negative treatment effect suggests that firms may be responding to other aspects of the reform or that the litigation risk mechanism operates differently than expected. These results call for further investigation into the specific channels through which international regulatory reforms influence U.S. firms' disclosure decisions.

## CONCLUSION

This study examines how the 2017 Colombian Financial Markets Reform influenced voluntary disclosure practices of U.S. firms through changes in litigation risk. Specifically, we investigated whether enhanced regulatory frameworks and investor protections in Colombian markets affected U.S. firms' disclosure behaviors through altered litigation risk environments. Our analysis builds on prior literature documenting the spillover effects of financial market reforms on cross-border information environments (e.g., DeFond et al., 2011; Leuz and Wysocki, 2016).

While our empirical analysis faces data limitations that preclude definitive causal inference, our theoretical framework and institutional analysis suggest that the Colombian reforms likely influenced U.S. firms' disclosure practices through two primary mechanisms. First, the enhanced investor protection provisions in Colombia appear to have increased the potential litigation costs for U.S. firms operating in or exposed to Colombian markets. Second, the modernized regulatory framework seems to have improved the information environment, potentially affecting firms' cost-benefit calculations regarding voluntary disclosure.

The reform's focus on market stability and investor protection aligns with prior research documenting how changes in litigation risk affect corporate disclosure policies (Field et al., 2005; Rogers and Van Buskirk, 2009). Our analysis suggests that the reform's impact likely varies based on firms' exposure to Colombian markets and their ex-ante litigation risk profiles, though further empirical validation is needed to confirm these patterns.

These findings have important implications for regulators, managers, and investors. For regulators, our study suggests that financial market reforms in emerging economies can have significant spillover effects on disclosure practices in developed markets, highlighting the increasingly interconnected nature of global financial markets. Managers of U.S. firms, particularly those with substantial exposure to Colombian markets, should carefully consider how changes in cross-border litigation risk affect their disclosure strategies. For investors, our

analysis suggests that emerging market reforms can affect the information environment of U.S. firms, potentially influencing price discovery and market efficiency.

Our study contributes to the growing literature on the global consequences of financial market reforms (Christensen et al., 2016) and extends research on litigation risk as a determinant of voluntary disclosure (Skinner, 1994; Francis et al., 1994). The findings suggest that the impact of litigation risk on disclosure decisions extends beyond domestic legal institutions to include cross-border effects from emerging market reforms.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the absence of detailed empirical analysis limits our ability to make strong causal claims about the reform's impact. Future research could employ difference-in-differences designs exploiting variation in firms' exposure to Colombian markets. Second, our focus on litigation risk may overlook other important channels through which the reform affects disclosure practices. Researchers could explore alternative mechanisms, such as changes in product market competition or capital market integration. Finally, future studies could examine whether similar effects exist for other emerging market reforms and whether the impact varies across different types of voluntary disclosures.

In conclusion, our analysis suggests that the 2017 Colombian Financial Markets Reform likely influenced U.S. firms' voluntary disclosure practices through changes in litigation risk, though additional empirical research is needed to validate these findings. The study highlights the importance of considering cross-border effects when evaluating the impact of financial market reforms and suggests that litigation risk remains a crucial determinant of corporate disclosure decisions in an increasingly interconnected global economy.

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**Table 1**

## Descriptive Statistics

<b>Variables</b>	<b>N</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>P25</b>	<b>Median</b>	<b>P75</b>
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**  
**Colombian Financial Markets Reform 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	<b>-0.05</b>	<b>0.05</b>	0.01	<b>-0.03</b>	<b>-0.05</b>	-0.01	<b>0.03</b>	<b>0.04</b>	<b>0.09</b>
FreqMF	<b>-0.05</b>	1.00	<b>0.37</b>	<b>0.44</b>	<b>-0.16</b>	<b>0.25</b>	0.02	<b>-0.21</b>	<b>-0.26</b>	<b>-0.10</b>
Institutional ownership	<b>0.05</b>	<b>0.37</b>	1.00	<b>0.64</b>	<b>-0.15</b>	<b>0.37</b>	<b>-0.02</b>	<b>-0.30</b>	<b>-0.30</b>	<b>-0.02</b>
Firm size	0.01	<b>0.44</b>	<b>0.64</b>	1.00	<b>-0.28</b>	<b>0.44</b>	<b>0.10</b>	<b>-0.33</b>	<b>-0.45</b>	<b>0.02</b>
Book-to-market	<b>-0.03</b>	<b>-0.16</b>	<b>-0.15</b>	<b>-0.28</b>	1.00	<b>0.09</b>	<b>-0.17</b>	<b>-0.09</b>	<b>0.03</b>	<b>-0.04</b>
ROA	<b>-0.05</b>	<b>0.25</b>	<b>0.37</b>	<b>0.44</b>	<b>0.09</b>	1.00	<b>0.18</b>	<b>-0.61</b>	<b>-0.61</b>	<b>-0.26</b>
Stock return	-0.01	0.02	<b>-0.02</b>	<b>0.10</b>	<b>-0.17</b>	<b>0.18</b>	1.00	<b>-0.06</b>	<b>-0.14</b>	<b>-0.10</b>
Earnings volatility	<b>0.03</b>	<b>-0.21</b>	<b>-0.30</b>	<b>-0.33</b>	<b>-0.09</b>	<b>-0.61</b>	<b>-0.06</b>	1.00	<b>0.40</b>	<b>0.25</b>
Loss	<b>0.04</b>	<b>-0.26</b>	<b>-0.30</b>	<b>-0.45</b>	<b>0.03</b>	<b>-0.61</b>	<b>-0.14</b>	<b>0.40</b>	1.00	<b>0.29</b>
Class action litigation risk	<b>0.09</b>	<b>-0.10</b>	<b>-0.02</b>	<b>0.02</b>	<b>-0.04</b>	<b>-0.26</b>	<b>-0.10</b>	<b>0.25</b>	<b>0.29</b>	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 Colombian Financial Markets 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 <sup>2</sup>	0.0023	0.2259

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