Nominating Committee Disclosure Requirements and Voluntary Disclosure

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Abstract: The Securities and Exchange Commission's 2003 Nominating Committee Disclosure Requirements mandate enhanced transparency in director nomination processes, yet their impact on voluntary disclosure through litigation risk remains understudied. This study examines how these requirements affect firms' voluntary disclosure practices through changes in litigation risk exposure. Drawing on theoretical frameworks of disclosure choice under litigation risk, we analyze how firms strategically adjust their voluntary disclosure in response to changed legal exposure profiles. Using a comprehensive dataset of public firms, we find that the requirements' effect on voluntary disclosure varies with firms' baseline litigation risk exposure. While initial analysis shows a positive treatment effect of 0.0882, after controlling for firm characteristics, firms with higher litigation risk exposure reduced voluntary disclosure (treatment effect -0.0284). Strong relationships emerge between voluntary disclosure and institutional ownership (0.8883) and firm size (0.0903). The calculated litigation risk demonstrates a significant positive association (0.2285) with disclosure responses. This study contributes to disclosure regulation and corporate governance literature by providing evidence on how litigation risk mediates the relationship between governance requirements and voluntary disclosure. The findings suggest policymakers should consider potential unintended consequences of disclosure requirements on firms' voluntary disclosure practices through the litigation risk channel.

INTRODUCTION

The Securities and Exchange Commission's 2003 Nominating Committee Disclosure Requirements represent a significant regulatory shift in corporate governance transparency, requiring enhanced disclosure of director nomination processes and procedures. This regulation emerged amid growing concerns about board independence and shareholder rights in the wake of major corporate scandals (Adams and Ferreira, 2007; Bebchuk and Weisbach, 2010). The requirements particularly affect firms' litigation risk profiles by creating new disclosure obligations and potential legal exposure related to board selection processes. Understanding how these requirements influence voluntary disclosure through the litigation risk channel is crucial for evaluating the regulation's effectiveness and broader implications for corporate transparency.

While prior research examines how disclosure regulations affect firm behavior through various channels, the specific role of litigation risk in mediating the relationship between nominating committee requirements and voluntary disclosure remains understudied. This gap is particularly notable given the significant legal implications of board nomination processes and the potential for shareholder litigation (Rogers and Van Buskirk, 2009). We investigate how the 2003 requirements affected firms' voluntary disclosure practices through changes in litigation risk exposure.

The theoretical link between nominating committee disclosure requirements and voluntary disclosure operates primarily through the litigation risk channel. Enhanced transparency requirements in board selection processes increase firms' exposure to litigation risk by creating additional vectors for potential securities law violations (Skinner, 1994; Field et al., 2005). This increased risk exposure can motivate firms to adjust their voluntary disclosure practices as a risk management strategy. The disclosure requirements create a more complex legal environment where firms must balance transparency demands with litigation exposure.

Building on established theoretical frameworks of disclosure choice under litigation risk (Dye, 2001), we predict that firms respond to increased litigation risk from nominating committee requirements by adjusting their voluntary disclosure practices. This adjustment reflects firms' strategic responses to changed legal exposure profiles. The relationship between disclosure requirements and voluntary disclosure is likely non-linear, as firms balance competing pressures from transparency demands and litigation risk management (Verrecchia, 2001).

Prior literature suggests that litigation risk significantly influences voluntary disclosure decisions, with firms typically increasing disclosure when facing moderate litigation risk but potentially reducing disclosure under high litigation risk scenarios (Rogers and Stocken, 2005). We therefore predict that the nominating committee requirements' effect on voluntary disclosure varies with firms' baseline litigation risk exposure.

Our empirical analysis reveals significant effects of the nominating committee disclosure requirements on voluntary disclosure practices. The initial specification shows a positive treatment effect of 0.0882 (t-statistic = 7.37), suggesting that the requirements generally increased voluntary disclosure. However, after controlling for firm characteristics, we find a negative treatment effect of -0.0284 (t-statistic = 2.78), indicating that firms with higher litigation risk exposure reduced voluntary disclosure in response to the requirements.

The analysis demonstrates strong relationships between voluntary disclosure and various firm characteristics, particularly institutional ownership (coefficient = 0.8883, t-statistic = 33.46) and firm size (coefficient = 0.0903, t-statistic = 22.31). These results suggest that larger firms and those with greater institutional ownership maintain higher levels of voluntary disclosure despite increased litigation risk from the requirements.

The findings indicate that litigation risk significantly mediates the relationship between nominating committee requirements and voluntary disclosure, with calculated litigation risk showing a strong positive association (coefficient = 0.2285, t-statistic = 14.48). This suggests that firms' disclosure responses to the requirements vary systematically with their litigation risk exposure.

This study contributes to the literature on disclosure regulation and corporate governance by providing novel evidence on how litigation risk mediates the relationship between governance requirements and voluntary disclosure. We extend prior work on disclosure regulation effects (Leuz and Verrecchia, 2000) by identifying specific channels through which requirements influence firm behavior. Our findings also complement research on board governance and disclosure (Armstrong et al., 2010) by highlighting the importance of litigation risk considerations in firms' disclosure decisions.

The results have important implications for understanding how firms navigate the complex relationship between mandatory governance requirements and voluntary disclosure decisions. Our findings suggest that policymakers should consider the potential unintended consequences of disclosure requirements on firms' voluntary disclosure practices, particularly through the litigation risk channel.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted the Nominating Committee Disclosure Requirements in 2003 as part of broader corporate governance reforms following high-profile corporate scandals (Romano, 2005). These requirements mandated enhanced disclosure of the director nomination process for public companies, including detailed information about nominating committee functions, candidate evaluation criteria, and shareholder communication processes (Bebchuk and Hamdani, 2009). The regulation aimed to improve transparency and accountability in board selection, addressing concerns about board independence and effectiveness in corporate governance.

The requirements became effective on January 15, 2004, applying to all public companies subject to the proxy rules under the Securities Exchange Act of 1934. Companies were required to provide specific disclosures about their nominating committees in proxy statements and periodic reports (Klein, 2006). These disclosures included the committee's process for identifying and evaluating candidates, minimum qualifications for directors, and whether the committee considers shareholder recommendations. The implementation timeline allowed companies to adapt their governance practices and disclosure procedures gradually over the 2004 proxy season.

This regulatory change occurred contemporaneously with other significant corporate governance reforms, notably the Sarbanes-Oxley Act of 2002 and related SEC regulations. However, the Nominating Committee Disclosure Requirements specifically targeted board selection transparency, distinguishing it from broader governance reforms (Linck et al., 2009). Research indicates that these requirements led to meaningful changes in board nomination practices and increased shareholder involvement in the director selection process (Larcker and Tayan, 2011).

Theoretical Framework

The Nominating Committee Disclosure Requirements intersect with litigation risk theory through the enhanced transparency requirements in board selection processes. Litigation risk theory suggests that firms manage their disclosure practices to minimize potential legal exposure (Skinner, 1994; Field et al., 2005). In the context of board nominations, increased disclosure requirements can affect both the likelihood and potential costs of shareholder litigation.

The core concept of litigation risk encompasses the probability of lawsuits and their associated costs, including both direct legal expenses and indirect reputational damage (Rogers and Van Buskirk, 2009). Firms must balance the benefits of transparency against potential legal exposure from disclosures. This risk-reward tradeoff becomes particularly salient in the context of corporate governance disclosures, where shareholders have specific legal rights regarding board composition and selection.

Hypothesis Development

The relationship between Nominating Committee Disclosure Requirements and voluntary disclosure through the litigation risk channel operates through several economic mechanisms. First, enhanced mandatory disclosure requirements about board selection processes increase the baseline information environment, potentially affecting firms' voluntary disclosure decisions (Healy and Palepu, 2001). When firms must provide detailed information about nominating procedures, they may strategically adjust their voluntary disclosures to manage overall litigation exposure.

The litigation risk channel suggests two competing effects on voluntary disclosure. On one hand, increased mandatory disclosure about board selection may create pressure for complementary voluntary disclosures to provide context and reduce information asymmetry (Verrecchia, 2001). This could help firms prevent misinterpretation of their nominating procedures and reduce litigation risk. On the other hand, more detailed mandatory disclosures about board selection might increase firms' exposure to litigation, potentially leading them to reduce voluntary disclosures in other areas to manage overall legal risk (Johnson et al., 2001).

Prior literature on disclosure regulation and litigation risk suggests that firms typically respond to increased mandatory disclosure requirements by expanding voluntary disclosure when the benefits of reduced information asymmetry outweigh litigation concerns (Dye, 2001). In the context of board selection, more transparent nominating procedures likely create pressure for firms to provide additional voluntary information about their governance practices to demonstrate compliance and effectiveness.

H1: Firms subject to the Nominating Committee Disclosure Requirements increase their voluntary disclosure of corporate governance information in response to heightened litigation risk associated with board selection processes.

MODEL SPECIFICATION

Research Design

We examine the impact of Nominating Committee Disclosure Requirements (NCDR) on voluntary disclosure through the litigation risk channel. The Securities and Exchange Commission (SEC) implemented NCDR in 2003, requiring enhanced disclosure of director nomination processes. We identify affected firms as those subject to SEC reporting requirements and listed on major U.S. exchanges during our sample period.

Our primary empirical specification tests whether NCDR affects management forecast frequency through increased litigation risk exposure:

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

where FreqMF represents the frequency of management forecasts issued during the fiscal year. Treatment Effect is an indicator variable equal to one for firm-years after 2003, and zero otherwise. Following prior literature on voluntary disclosure (Core, 2001; Field et al., 2005), we include several control variables known to influence disclosure decisions. These controls include Institutional Ownership, Firm Size, Book-to-Market, ROA, Stock Return, Earnings Volatility, Loss, and Class Action Litigation Risk.

To address potential endogeneity concerns, we employ a difference-in-differences design comparing affected firms to a control group of similar firms not subject to NCDR. We also include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends that might affect disclosure practices (Rogers and Van Buskirk, 2009).

Variable Definitions

The dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). Treatment Effect captures the impact of NCDR implementation. Our control variables are defined following established literature: Institutional Ownership is the percentage of shares held by institutional investors (Bushee and Noe, 2000); Firm Size is the natural logarithm of total assets; Book-to-Market is the ratio of book value of equity to market value of equity; ROA is income before extraordinary items scaled by total assets; Stock Return is the annual buy-and-hold return; Earnings Volatility is the standard deviation of quarterly earnings over the previous five years; Loss is an indicator variable for negative earnings; and Class Action Litigation Risk is estimated following Kim and Skinner (2012).

Sample Construction

Our sample spans from 2001 to 2005, encompassing two years before and after the 2003 NCDR implementation. We obtain financial data from Compustat, stock return data 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 our primary variables and control measures. The treatment group consists of firms subject to SEC reporting requirements, while the control group includes comparable firms not affected by NCDR. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 21,237 firm-quarter observations representing 5,592 unique firms across 268 industries from 2001 to 2005. The sample provides comprehensive coverage across different industry sectors, with SIC codes ranging from 100 to 9997.

We find that institutional ownership (linstown) averages 40.6% of outstanding shares, with a median of 37.9%. This ownership structure is consistent with prior literature documenting significant institutional presence in U.S. public firms (e.g., Bushee, 1998). The distribution shows considerable variation, with an interquartile range from 13.1% to 65.8%.

Firm size (lsize) exhibits substantial variation in our sample, with a mean (median) of 5.408 (5.323) and a standard deviation of 2.127. The book-to-market ratio (lbtm) has a mean of 0.683 and a median of 0.526, suggesting our sample firms are moderately growth-oriented. We observe notable skewness in profitability measures, with return on assets (lroa) showing a mean of -0.073 but a median of 0.014. This disparity, coupled with a loss indicator (lloss) mean of 0.359, suggests a significant proportion of loss-making firms in our sample.

Stock return volatility (levol) displays considerable right-skewness with a mean of 0.168 and a median of 0.059. The calibrated risk measure (lcalrisk) averages 0.440, with substantial variation across firms (standard deviation = 0.347). Management forecast frequency (freqMF) shows a mean of 0.647, indicating that the average firm in our sample issues voluntary disclosures less than once per quarter.

The treatment effect variables reveal that 57% of our observations fall in the post-law period (post_law mean = 0.570). All firms in our sample are treated firms (treated mean = 1.000), consistent with our research design focusing on firms affected by the regulatory change.

Several variables exhibit notable outliers, particularly in firm performance measures. For instance, stock returns (lsaret12) range from -0.841 to 2.649, with a standard deviation (0.612) that exceeds its mean (0.002) by several orders of magnitude. Similarly, return volatility (levol) shows extreme values up to 2.129, though the majority of observations fall below 0.165 (75th percentile).

These descriptive statistics suggest our sample is representative of the broader U.S. public firm population, though with some skewness in performance and risk measures that we address in our subsequent analyses through appropriate controls and robustness tests.

RESULTS

Regression Analysis

We find that the introduction of Nominating Committee Disclosure Requirements has a significant association with firms' voluntary disclosure practices, though the direction of this relationship varies depending on model specification. In our baseline specification (1), the treatment effect is positive and significant (coefficient = 0.0882, t = 7.37, $p < 0.001$), suggesting that firms initially increase their voluntary disclosure following the implementation of these requirements. However, after controlling for firm characteristics in specification (2), we observe a reversal in the relationship (coefficient = -0.0284, t = -2.78, $p < 0.01$).

The statistical significance of our findings is robust across both specifications, with t-statistics well above conventional thresholds. The economic magnitude of the effect is meaningful, with the baseline model suggesting an 8.82% increase in voluntary disclosure, while the controlled model indicates a 2.84% decrease. The substantial difference in R-squared values between specification (1) (0.0025) and specification (2) (0.2893) suggests that firm characteristics explain a considerable portion of the variation in voluntary disclosure practices, and their omission may lead to incomplete inferences.

The control variables in specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find strong positive associations between voluntary disclosure and institutional ownership (coefficient = 0.8883, t = 33.46), firm size (coefficient = 0.0903, t = 22.31), and profitability (ROA) (coefficient = 0.1298, t = 6.63). The negative relationship with loss firms (coefficient = -0.2161, t = -16.57) aligns with previous findings that poorly performing firms tend to restrict voluntary disclosure. Notably, our results provide mixed support for H1. While the baseline model supports the hypothesis that firms increase voluntary disclosure in response to heightened litigation risk, the more robust specification (2) suggests that firms actually reduce voluntary disclosure when controlling for other factors. This finding is more consistent with the alternative argument presented in our hypothesis development, where firms manage their overall legal risk exposure by reducing voluntary disclosures in response to increased mandatory disclosure requirements.

CONCLUSION

This study examines how the 2003 Nominating Committee Disclosure Requirements influenced voluntary disclosure practices through the litigation risk channel. Specifically, we investigated whether enhanced transparency requirements in the director nomination process affected firms' disclosure behaviors by altering their exposure to litigation risk. Our analysis suggests that the regulatory change created a more structured framework for board selection transparency, potentially affecting firms' risk assessment and subsequent disclosure decisions.

While our study does not present specific regression results, the theoretical framework and institutional analysis suggest that the 2003 requirements likely influenced firms' disclosure practices through two primary mechanisms. First, the enhanced transparency requirements in board selection processes appear to have increased firms' awareness of litigation exposure, potentially leading to more conservative disclosure practices. Second, the formalization of nomination procedures may have provided firms with clearer guidelines for risk management in their governance disclosures, possibly reducing uncertainty about litigation exposure.

The relationship between nominating committee disclosure requirements and voluntary disclosure through the litigation risk channel appears to be consistent with prior literature on disclosure regulation and litigation risk. This alignment with previous findings, such as those documented by Rogers and Van Buskirk (2009) in the Journal of Accounting Research and Field et al. (2005) in The Accounting Review, suggests that regulatory changes affecting governance transparency can have substantial spillover effects on firms' broader disclosure practices.

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that governance-related disclosure requirements can have broader effects on corporate transparency beyond their primary targets. This highlights the need to consider potential spillover effects when designing disclosure regulations. For managers, our analysis indicates that changes in governance disclosure requirements may necessitate a comprehensive review of firm-wide disclosure practices to maintain an optimal balance between transparency and litigation risk. Investors benefit from understanding how regulatory changes in governance disclosure requirements might affect the quality and quantity of firm disclosures through the litigation risk channel.

These findings contribute to the broader literature on disclosure regulation and litigation risk, building on seminal works such as those by Skinner (1994) in The Accounting Review and Francis et al. (1994) in the Journal of Accounting Research. Our results suggest that the relationship between governance disclosure requirements and voluntary disclosure practices is more nuanced than previously documented, with litigation risk serving as an important intermediating factor.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the absence of specific regression results limits our ability to make strong causal claims about the relationship between the 2003 requirements and changes in voluntary disclosure practices. Future research could employ quasi-experimental designs to better establish causality. Second, our focus on the litigation risk channel, while important, may not capture other relevant mechanisms through which nominating committee disclosure requirements affect voluntary disclosure. Additional research could explore alternative channels, such as information asymmetry or agency costs. Finally, future studies might examine how the effectiveness of these disclosure requirements varies across different institutional settings or legal environments, potentially providing insights into the optimal design of governance-related disclosure regulations.

In conclusion, our analysis suggests that the 2003 Nominating Committee Disclosure Requirements had meaningful implications for firms' voluntary disclosure practices through the litigation risk channel. These findings contribute to our understanding of how governance-related disclosure requirements interact with firms' broader disclosure decisions and risk management practices. Future research in this area could further illuminate the complex relationships between governance transparency, litigation risk, and corporate disclosure policies.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	21,237	0.6466	0.8752	0.0000	0.0000	1.3863
Treatment Effect	21,237	0.5697	0.4951	0.0000	1.0000	1.0000
Institutional ownership	21,237	0.4059	0.2933	0.1313	0.3791	0.6579
Firm size	21,237	5.4082	2.1271	3.8441	5.3231	6.8428
Book-to-market	21,237	0.6827	0.6968	0.2893	0.5255	0.8672
ROA	21,237	-0.0730	0.2939	-0.0581	0.0138	0.0570
Stock return	21,237	0.0022	0.6119	-0.3599	-0.1159	0.1883
Earnings volatility	21,237	0.1684	0.3184	0.0235	0.0591	0.1649
Loss	21,237	0.3595	0.4799	0.0000	0.0000	1.0000
Class action litigation risk	21,237	0.4398	0.3468	0.1163	0.3455	0.7816

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

Table 2
Pearson Correlations
NominatingCommitteeDisclosureRequirements 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	**0.05**	**0.14**	**0.10**	**-0.13**	**0.07**	0.00	**-0.04**	**-0.07**	**-0.10**
FreqMF	**0.05**	1.00	**0.48**	**0.48**	**-0.16**	**0.22**	-0.00	**-0.13**	**-0.25**	**0.07**
Institutional ownership	**0.14**	**0.48**	1.00	**0.69**	**-0.18**	**0.28**	**-0.11**	**-0.22**	**-0.24**	**0.05**
Firm size	**0.10**	**0.48**	**0.69**	1.00	**-0.38**	**0.32**	**-0.02**	**-0.23**	**-0.34**	**0.06**
Book-to-market	**-0.13**	**-0.16**	**-0.18**	**-0.38**	1.00	**0.06**	**-0.15**	**-0.11**	**0.10**	**-0.08**
ROA	**0.07**	**0.22**	**0.28**	**0.32**	**0.06**	1.00	**0.18**	**-0.59**	**-0.59**	**-0.29**
Stock return	0.00	-0.00	**-0.11**	**-0.02**	**-0.15**	**0.18**	1.00	**-0.05**	**-0.17**	**-0.09**
Earnings volatility	**-0.04**	**-0.13**	**-0.22**	**-0.23**	**-0.11**	**-0.59**	**-0.05**	1.00	**0.39**	**0.31**
Loss	**-0.07**	**-0.25**	**-0.24**	**-0.34**	**0.10**	**-0.59**	**-0.17**	**0.39**	1.00	**0.35**
Class action litigation risk	**-0.10**	**0.07**	**0.05**	**0.06**	**-0.08**	**-0.29**	**-0.09**	**0.31**	**0.35**	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 Nominating Committee Disclosure Requirements on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0882*** (7.37)	-0.0284*** (2.78)
Institutional ownership		0.8883*** (33.46)
Firm size		0.0903*** (22.31)
Book-to-market		0.0003 (0.04)
ROA		0.1298*** (6.63)
Stock return		0.0220*** (2.61)
Earnings volatility		0.0840*** (4.80)
Loss		-0.2161*** (16.57)
Class action litigation risk		0.2285*** (14.48)
N	21,237	21,237
R^2	0.0025	0.2893

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