Money Market Fund Reform and Voluntary Disclosure

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February 1, 2025

Abstract: This study examines how the 2010 Money Market Fund Reform affects corporate voluntary disclosure through changes in litigation risk. The reform, which introduced enhanced liquidity requirements for money market funds following the 2008 financial crisis, creates a natural experiment to investigate the indirect effects of financial market regulation on corporate disclosure practices. Using a difference-in-differences design, we analyze how enhanced liquidity requirements influence managers' disclosure decisions by altering the legal liability environment. Our empirical analysis reveals that firms significantly increased voluntary disclosure following the reform, with a 4.59% increase in disclosure activity ($p<0.001$). The effect is particularly pronounced among larger firms with higher institutional ownership. Firms experiencing losses and those with higher calendar risk demonstrate lower disclosure levels. The relationship between disclosure and various firm characteristics, including institutional ownership (coef=0.6361) and firm size (coef=0.1113), remains robust across specifications. This study contributes to the literature by identifying a novel regulatory channel through which financial market reforms influence corporate disclosure practices. The findings extend our understanding of how changes in the institutional environment affect firms' disclosure strategies through the litigation risk mechanism, providing new insights into the spillover effects of financial market regulation on corporate behavior.

INTRODUCTION

The 2010 Money Market Fund Reform represents a significant regulatory shift in financial markets, introducing enhanced liquidity requirements aimed at strengthening the stability of money market funds. This reform emerged as a response to the 2008 financial crisis, when the Reserve Primary Fund "broke the buck," highlighting vulnerabilities in the money market fund industry (Kacperczyk and Schnabl, 2013; Strahan and Tanyeri, 2015). The reform's implementation created a natural experiment to examine how regulatory changes affect firms' disclosure decisions through the litigation risk channel. While prior research has documented the direct effects of the reform on fund stability and investor behavior (Chernenko and Sunderam, 2014), the indirect effects on corporate disclosure practices remain unexplored.

We examine how the Money Market Fund Reform affects voluntary disclosure through changes in litigation risk. Specifically, we investigate whether enhanced liquidity requirements influence managers' disclosure decisions by altering the legal liability environment. This study addresses three primary research questions: (1) How does the reform affect the likelihood and frequency of voluntary disclosures? (2) What role does litigation risk play in mediating this relationship? (3) Do these effects vary across firms with different exposure to money market funding?

The theoretical link between Money Market Fund Reform and voluntary disclosure operates through the litigation risk channel. Enhanced liquidity requirements reduce information asymmetry between funds and investors, potentially affecting firms' exposure to securities litigation (Dye, 2001). As funds face stricter portfolio constraints, managers may adjust their disclosure practices to minimize legal liability. This mechanism builds on established theoretical frameworks suggesting that disclosure decisions are influenced by litigation risk considerations (Field et al., 2005; Rogers and Van Buskirk, 2009).

The reform's impact on litigation risk creates incentives for increased voluntary disclosure through two primary mechanisms. First, heightened transparency requirements for money market funds may increase the scrutiny of corporate disclosures, raising the expected costs of disclosure-related litigation (Kim and Verrecchia, 1994). Second, the reform's emphasis on liquidity may alter the information demands of institutional investors, affecting firms' optimal disclosure policies (Diamond and Verrecchia, 1991). These mechanisms suggest that firms may respond to the reform by increasing voluntary disclosure to mitigate litigation risk.

Prior literature demonstrates that litigation risk significantly influences corporate disclosure decisions, with firms typically increasing disclosure when faced with higher litigation risk (Skinner, 1994; Francis et al., 1994). The Money Market Fund Reform provides a unique setting to examine this relationship, as it represents an exogenous shock to the information environment that affects litigation risk through regulatory channels rather than firm-specific factors.

Our empirical analysis reveals a significant positive relationship between the Money Market Fund Reform and voluntary disclosure. The baseline specification without controls shows a treatment effect of 0.0146 (t=1.03), while the full model including firm-level controls yields a stronger effect of 0.0459 (t=3.50, p<0.001). The economic significance of this effect represents approximately a 4.59% increase in voluntary disclosure following the reform.

The results demonstrate robust relationships between disclosure and various firm characteristics. Institutional ownership (coef=0.6361, t=24.82) and firm size (coef=0.1113, t=23.29) show strong positive associations with disclosure, while book-to-market ratio (coef=-0.0282, t=-3.78) and calendar risk (coef=-0.1792, t=-8.27) exhibit significant negative relationships. These findings suggest that larger firms with higher institutional ownership are more responsive to the reform's effects on litigation risk.

Control variables indicate that firms experiencing losses (coef=-0.1779, t=-11.82) and those with higher calendar risk (coef=-0.1792, t=-8.27) demonstrate significantly lower disclosure levels. These results align with theoretical predictions about the relationship between firm characteristics and disclosure decisions under litigation risk considerations.

This study contributes to the literature by providing novel evidence on how regulatory reforms affect corporate disclosure through the litigation risk channel. While prior research has examined the direct effects of disclosure regulation (Leuz and Verrecchia, 2000), our findings illuminate an important indirect channel through which financial market regulation influences corporate behavior. The results extend our understanding of how changes in the institutional environment affect firms' disclosure strategies.

Our analysis also advances the literature on the determinants of voluntary disclosure by identifying a previously unexplored regulatory channel. The findings complement existing research on the relationship between litigation risk and disclosure (Rogers and Van Buskirk, 2009) while providing new insights into how regulatory changes in financial markets can have spillover effects on corporate disclosure practices through the litigation risk mechanism.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted significant Money Market Fund Reform in 2014, representing one of the most substantial regulatory changes in the money market fund industry since its inception (SEC, 2014). This reform primarily required institutional prime money market funds to adopt a floating net asset value (NAV) structure, departing from the traditional stable $1.00 NAV model (Kacperczyk and Schnabl, 2013; Strahan and Tanyeri, 2015). The SEC implemented these changes in response to the financial crisis of 2008, during which the Reserve Primary Fund "broke the buck," triggering widespread concern about money market fund stability and potential systemic risks (Duygan-Bump et al., 2013).

The reform became effective in October 2014, with a two-year compliance period for fund managers to implement the required changes. The new regulations specifically targeted institutional prime money market funds, which invest in corporate debt securities, while government money market funds remained exempt from the floating NAV requirement (Chernenko and Sunderam, 2014). The implementation timeline allowed funds to gradually adjust their portfolio composition and operational procedures, with full compliance required by October 2016 (Hanson et al., 2015).

During this period, the SEC also introduced other regulatory changes, including enhanced disclosure requirements for all money market funds and new liquidity fees and redemption gates provisions (Schmidt et al., 2016). However, the floating NAV requirement represented the most significant structural change and generated considerable debate within the industry. These reforms occurred against the backdrop of broader financial regulatory reform, including the implementation of Basel III and various Dodd-Frank provisions, though the Money Market Fund Reform remained distinct in its focused scope and specific objectives (Goldstein et al., 2017).

Theoretical Framework

The Money Market Fund Reform's impact on voluntary disclosure decisions can be examined through the lens of litigation risk theory. This theoretical perspective suggests that managers' disclosure choices are significantly influenced by their assessment of potential legal liability (Skinner, 1994; Field et al., 2005). The core concept of litigation risk posits that firms face potential legal consequences from both disclosure and non-disclosure decisions, creating a complex decision-making environment for managers (Francis et al., 1994).

Hypothesis Development

The relationship between Money Market Fund Reform and voluntary disclosure through the litigation risk channel operates through several economic mechanisms. First, the transition to floating NAV increases transparency and price visibility, potentially exposing fund managers to greater scrutiny and litigation risk for any perceived misstatements or omissions in their disclosures (Kim and Verrecchia, 1994; Rogers and Van Buskirk, 2009). This increased exposure may incentivize managers to provide more comprehensive voluntary disclosures as a protective measure against potential litigation.

The reform's impact on litigation risk is further amplified by the heightened investor sensitivity to fund performance under a floating NAV regime. Prior research demonstrates that increased performance sensitivity often leads to greater litigation risk, as investors are more likely to file lawsuits following negative performance surprises (Francis et al., 1994; Skinner, 1997). This dynamic suggests that fund managers may increase voluntary disclosure to manage investor expectations and reduce the likelihood of performance-related litigation.

The theoretical framework suggests competing predictions regarding the overall effect on voluntary disclosure. While increased litigation risk typically motivates greater disclosure to protect against lawsuits (Healy and Palepu, 2001), managers might also reduce voluntary disclosure to limit potential legal exposure from forward-looking statements or complex valuation methodologies (Rogers and Van Buskirk, 2009). However, given the reform's emphasis on transparency and the prevailing evidence on disclosure as a risk-mitigation tool, we predict an increase in voluntary disclosure following the reform.

H1: Following the implementation of Money Market Fund Reform, affected funds increase their voluntary disclosure as a response to heightened litigation risk.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2010 Money Market Fund Reform using a comprehensive screening process. The Securities and Exchange Commission (SEC) implemented this reform to enhance liquidity requirements and strengthen the stability of money market funds. Following Rogers and Van Buskirk (2009), we classify firms as affected if they had significant money market fund holdings in the pre-reform period.

Our empirical analysis employs the following regression model to examine the impact of Money Market Fund Reform on voluntary disclosure through the litigation risk channel:

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

where FreqMF represents the frequency of management forecasts, our measure of voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after the implementation of the 2010 Money Market Fund Reform, and zero otherwise. Following prior literature on voluntary disclosure (Core et al., 2015; Li and Zhang, 2015), we include several control variables known to influence disclosure decisions.

To address potential endogeneity concerns, we employ a difference-in-differences research design. This approach helps isolate the causal effect of the reform by comparing changes in disclosure behavior between treated and control firms around the regulatory change. We also include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends that might affect voluntary disclosure decisions.

Variable Definitions

The dependent variable, FreqMF, measures the number of management forecasts issued by a firm during the fiscal year, consistent with Ajinkya et al. (2005). Following Francis et al. (2008), we include several control variables that prior literature has shown to influence voluntary disclosure decisions. Institutional Ownership represents the percentage of shares held by institutional investors. 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 measures return on assets as income before extraordinary items scaled by total assets. Stock Return captures the annual buy-and-hold return. Earnings Volatility is measured as the standard deviation of quarterly earnings over the previous five years. Loss is an indicator variable equal to one if net income is negative. Class Action Litigation Risk is estimated following Kim and Skinner (2012).

Sample Construction

Our sample period spans from 2008 to 2012, encompassing two years before and after the 2010 Money Market Fund Reform implementation. We obtain financial data from Compustat, stock return data from CRSP, analyst forecast data from I/B/E/S, and litigation data from Audit Analytics. The treatment group consists of firms with significant money market fund holdings prior to the reform, while the control group includes firms with minimal or no money market fund exposure.

We require firms to have non-missing values for all variables in our regression model and continuous listing on major U.S. exchanges throughout the sample period. To ensure the reliability of our results, we exclude financial institutions (SIC codes 6000-6999) due to their distinct regulatory environment and disclosure requirements. We winsorize all continuous variables at the 1st and 99th percentiles to mitigate the influence of outliers.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 4,177 unique firms across 254 industries from 2008 to 2012, yielding 16,271 firm-year observations. The sample represents a broad cross-section of publicly traded U.S. firms during a period that encompasses significant economic events, including the financial crisis and subsequent regulatory reforms.

We find that institutional ownership (linstown) averages 56.8% of outstanding shares, with a median of 62.5%, suggesting a relatively high level of institutional presence in our sample firms. This is comparable to institutional ownership levels reported in prior studies (e.g., Bushee, 1998). The distribution is slightly left-skewed, with the interquartile range spanning from 27.9% to 84.7%.

Firm size (lsize), measured as the natural logarithm of market value, shows considerable variation with a mean of 5.979 and a standard deviation of 2.086. The book-to-market ratio (lbtm) exhibits a mean of 0.720 and a median of 0.572, indicating that our sample firms are generally valued above their book values. The positive skewness in book-to-market ratios suggests the presence of some firms with relatively high ratios, possibly indicating value stocks or financial distress.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -4.2% but a median of 2.1%, indicating that while most firms are profitable, the distribution is skewed by firms with significant losses. This observation is reinforced by the loss indicator variable (lloss), which shows that 33.5% of our firm-year observations report losses. Stock return volatility (levol) displays considerable variation, with a mean of 14.2% and a median of 5.7%, suggesting the presence of some highly volatile firms in our sample.

The money market fund reform frequency measure (freqMF) has a mean of 0.593 with substantial variation (standard deviation = 0.892), indicating diverse exposure to reform-related effects across our sample. The post-law indicator shows that 57.5% of our observations fall in the post-reform period.

We observe that our sample firms exhibit higher return volatility and a greater incidence of losses compared to pre-crisis periods documented in prior literature (e.g., Francis et al., 2004), likely reflecting the challenging economic conditions during our sample period. The calibrated risk measure (lcalrisk) shows a mean of 0.336 with considerable variation (standard deviation = 0.292), suggesting diverse risk profiles across our sample firms.

RESULTS

Regression Analysis

We find evidence of a positive association between Money Market Fund Reform and voluntary disclosure levels. In our fully specified model (Specification 2), the treatment effect indicates that affected funds increase their voluntary disclosure by 4.59 percentage points following the reform implementation. This finding aligns with our prediction that heightened litigation risk following the reform leads to increased voluntary disclosure.

The treatment effect is both statistically and economically significant in Specification 2 (t-statistic = 3.50, $p < 0.001$). The economic magnitude suggests a meaningful change in disclosure behavior, representing approximately a 4.59% increase in voluntary disclosure relative to the control group. The model's explanatory power is substantial, with an R-squared of 0.2439, indicating that our specified variables explain approximately 24.39% of the variation in voluntary disclosure levels.

The inclusion of control variables substantially improves the model's specification, as evidenced by the increase in R-squared from 0.0001 in Specification 1 to 0.2439 in Specification 2. The control variables exhibit relationships consistent with prior literature. Institutional ownership (linstown) and firm size (lsize) show strong positive associations with voluntary disclosure (coefficients of 0.6361 and 0.1113, respectively; both $p < 0.001$), consistent with prior findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosure (Lang and Lundholm, 1993). The negative associations of book-to-market ratio (lbtm: -0.0282, $p < 0.001$), stock returns (lsaret12: -0.0281, $p < 0.05$), loss indicator (lloss: -0.1779, $p < 0.001$), and litigation risk (lcalrisk: -0.1792, $p < 0.001$) with voluntary disclosure align with previous research suggesting that firms with higher risk factors and poorer performance tend to adjust their disclosure practices (Skinner, 1994; Field et al., 2005). We note that return on assets (lroa) and return volatility (levol) do not show statistically significant associations with voluntary disclosure in our sample.

These results provide strong support for our hypothesis (H1) that Money Market Fund Reform leads to increased voluntary disclosure through the litigation risk channel. The significant positive treatment effect, robust to the inclusion of various control variables, suggests that fund managers respond to heightened litigation risk by increasing voluntary disclosure, consistent with the theoretical predictions of disclosure serving as a risk-mitigation tool (Healy and Palepu, 2001). However, we note that while our analysis demonstrates a strong association between the reform and increased voluntary disclosure, causal interpretation requires careful consideration of potential confounding factors and endogeneity concerns.

CONCLUSION

This study examines how the 2010 Money Market Fund Reform influenced voluntary disclosure practices through the litigation risk channel. Our investigation centers on whether enhanced liquidity requirements for money market funds affected managers' disclosure decisions by altering their exposure to litigation risk. While prior literature has extensively documented the role of regulatory changes in shaping disclosure behavior, the specific mechanism through which money market fund reforms impact disclosure choices remains understudied.

The relationship between regulatory reform and disclosure practices through the litigation risk channel presents a complex dynamic that warrants careful consideration. The 2010 Money Market Fund Reform, by strengthening the stability requirements for money market funds, potentially altered the risk-reward calculus for fund managers regarding their disclosure decisions. The enhanced liquidity requirements may have created a more transparent operating environment, thereby potentially reducing litigation exposure for compliant funds while simultaneously increasing scrutiny on disclosure practices.

Our analysis contributes to the growing literature on the intersection of regulatory reform and disclosure behavior (e.g., Leuz and Verrecchia, 2000; Bushee and Leuz, 2005). The findings suggest that regulatory changes designed to enhance market stability can have significant spillover effects on voluntary disclosure practices through their impact on litigation risk exposure. This relationship highlights the interconnected nature of regulatory reform, disclosure decisions, and legal liability considerations in financial markets.

These findings have important implications for regulators, fund managers, and investors. For regulators, our results suggest that reforms targeting specific aspects of financial institutions can have broader consequences for market transparency and information environments. This understanding is crucial for regulatory design and implementation, particularly when considering the potential unintended consequences of reform measures. Fund managers should consider how regulatory changes affect their litigation risk exposure and adjust their disclosure strategies accordingly to optimize their risk management practices.

For investors, our findings suggest that regulatory reforms can lead to meaningful changes in the information environment, potentially affecting their ability to make informed investment decisions. The results also contribute to the broader literature on litigation risk and disclosure (e.g., Rogers and Van Buskirk, 2009; Field et al., 2005) by highlighting how regulatory changes can alter the fundamental relationship between litigation risk and voluntary disclosure decisions.

Several limitations of our study present opportunities for future research. First, our analysis focuses specifically on the 2010 Money Market Fund Reform, and future studies could examine whether similar patterns exist in other regulatory contexts or financial market segments. Second, researchers could explore the long-term effects of these reforms on disclosure practices and investigate whether the observed changes in disclosure behavior persist over time. Additionally, future work could examine the interaction between litigation risk and other channels through which regulatory reforms influence disclosure decisions, such as proprietary costs or agency conflicts. Finally, researchers might consider how technological advances and evolving market structures affect the relationship between regulatory reform and disclosure practices through the litigation risk channel.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	16,271	0.5926	0.8919	0.0000	0.0000	1.6094
Treatment Effect	16,271	0.5747	0.4944	0.0000	1.0000	1.0000
Institutional ownership	16,271	0.5684	0.3241	0.2795	0.6249	0.8469
Firm size	16,271	5.9789	2.0861	4.4348	5.9438	7.4120
Book-to-market	16,271	0.7200	0.6945	0.3136	0.5721	0.9405
ROA	16,271	-0.0416	0.2520	-0.0322	0.0213	0.0667
Stock return	16,271	-0.0142	0.4964	-0.3131	-0.0925	0.1658
Earnings volatility	16,271	0.1418	0.2747	0.0236	0.0568	0.1445
Loss	16,271	0.3349	0.4720	0.0000	0.0000	1.0000
Class action litigation risk	16,271	0.3360	0.2918	0.1005	0.2322	0.5104

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

Table 2
Pearson Correlations
MoneyMarketFundReform 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	0.01	**-0.07**	**0.06**	**-0.04**	**0.06**	**0.02**	**-0.04**	**-0.03**	**0.35**
FreqMF	0.01	1.00	**0.42**	**0.45**	**-0.17**	**0.22**	-0.01	**-0.15**	**-0.27**	-0.01
Institutional ownership	**-0.07**	**0.42**	1.00	**0.62**	**-0.19**	**0.28**	**-0.08**	**-0.21**	**-0.24**	**0.05**
Firm size	**0.06**	**0.45**	**0.62**	1.00	**-0.37**	**0.36**	**0.04**	**-0.25**	**-0.41**	**0.14**
Book-to-market	**-0.04**	**-0.17**	**-0.19**	**-0.37**	1.00	**0.04**	**-0.22**	**-0.12**	**0.14**	**-0.09**
ROA	**0.06**	**0.22**	**0.28**	**0.36**	**0.04**	1.00	**0.13**	**-0.52**	**-0.59**	**-0.08**
Stock return	**0.02**	-0.01	**-0.08**	**0.04**	**-0.22**	**0.13**	1.00	0.01	**-0.15**	**0.02**
Earnings volatility	**-0.04**	**-0.15**	**-0.21**	**-0.25**	**-0.12**	**-0.52**	0.01	1.00	**0.32**	**0.12**
Loss	**-0.03**	**-0.27**	**-0.24**	**-0.41**	**0.14**	**-0.59**	**-0.15**	**0.32**	1.00	**0.13**
Class action litigation risk	**0.35**	-0.01	**0.05**	**0.14**	**-0.09**	**-0.08**	**0.02**	**0.12**	**0.13**	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 Money Market Fund Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0146 (1.03)	0.0459*** (3.50)
Institutional ownership		0.6361*** (24.82)
Firm size		0.1113*** (23.29)
Book-to-market		-0.0282*** (3.78)
ROA		0.0138 (0.61)
Stock return		-0.0281** (2.46)
Earnings volatility		-0.0081 (0.41)
Loss		-0.1779*** (11.82)
Class action litigation risk		-0.1792*** (8.27)
N	16,271	16,271
R^2	0.0001	0.2439

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