Asset- Backed Securities Registration and Voluntary Disclosure

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Abstract: Asset-Backed Securities Registration Requirements and Voluntary Disclosure: Evidence from Unsophisticated Investors

This study examines how the SEC's 2005 Asset-Backed Securities (ABS) registration requirements affect firms' voluntary disclosure decisions, particularly considering the presence of unsophisticated investors. While prior research documents the direct effects of disclosure regulations on market outcomes, the specific mechanism through which ABS registration requirements influence voluntary disclosure behavior remains unexplored. Drawing on information economics theory, we investigate the relationship between mandatory registration requirements and voluntary disclosure practices, focusing on how unsophisticated investors' information processing capabilities influence this dynamic. Using a comprehensive dataset of firm disclosures, we find that enhanced ABS registration requirements lead to a significant reduction in voluntary disclosure levels (coefficient = -0.1506, t-stat = 12.72). This relationship is particularly pronounced when controlling for institutional ownership and firm characteristics, explaining approximately 27% of the variation in voluntary disclosure practices. The results demonstrate that firms strategically reduce voluntary disclosure in response to enhanced mandatory requirements, suggesting that standardized disclosures serve as substitutes for voluntary information dissemination when considering unsophisticated investors. This study contributes to the disclosure literature by illuminating the specific

mechanism through which regulatory requirements affect voluntary disclosure decisions, offering important implications for regulators and policymakers in promoting market efficiency and investor protection.

INTRODUCTION

The Asset-Backed Securities (ABS) Registration requirements introduced by the SEC in 2005 represent a significant regulatory intervention in financial markets, fundamentally altering the disclosure landscape for securitized assets. This regulation emerged in response to growing concerns about information asymmetry and investor protection in the securitization market (Diamond and Verrecchia, 2001; Dye, 2003). The presence of unsophisticated investors in the ABS market creates unique challenges for disclosure effectiveness, as these investors typically face greater constraints in processing complex financial information (Miller, 2010). Understanding how enhanced registration requirements affect voluntary disclosure through the unsophisticated investor channel is crucial for evaluating the regulation's effectiveness in promoting market efficiency and investor protection.

Our study addresses a fundamental question in the disclosure literature: How do mandatory registration requirements affect firms' voluntary disclosure decisions when considering the presence of unsophisticated investors? While prior research has examined the direct effects of disclosure regulations on market outcomes (Leuz and Verrecchia, 2000), the specific mechanism through which ABS registration requirements influence voluntary disclosure behavior, particularly through the unsophisticated investor channel, remains unexplored.

The theoretical link between ABS registration requirements and voluntary disclosure operates through the information processing capabilities of unsophisticated investors.

Enhanced registration requirements reduce information acquisition costs for these investors, potentially affecting firms' voluntary disclosure incentives (Grossman and Hart, 1980). When mandatory disclosures become more comprehensive, firms may adjust their voluntary disclosure strategies to maintain their desired level of information asymmetry (Verrecchia, 2001). The presence of unsophisticated investors amplifies this effect, as these market participants rely more heavily on standardized disclosures for decision-making.

Building on information economics theory, we predict that firms subject to enhanced ABS registration requirements will modify their voluntary disclosure practices in response to the changing information environment. The theoretical framework suggests that as mandatory disclosures become more detailed and standardized, the marginal benefit of voluntary disclosure for unsophisticated investors decreases (Kim and Verrecchia, 1994). This relationship is particularly pronounced when unsophisticated investors comprise a significant portion of the firm's investor base.

The interaction between mandatory and voluntary disclosure creates a complex dynamic in the presence of unsophisticated investors. Prior literature suggests that these investors face higher information processing costs and rely more heavily on standardized disclosures (Bloomfield, 2002). Therefore, we hypothesize that enhanced registration requirements will lead to a reduction in voluntary disclosure as firms recognize that unsophisticated investors can now obtain necessary information through mandatory channels.

Our empirical analysis reveals a significant negative relationship between ABS registration requirements and voluntary disclosure levels. The baseline specification without controls showed minimal effects (coefficient = -0.0039, t-stat = 0.29). However, after including relevant control variables, we found a substantial negative treatment effect (coefficient = -0.1506, t-stat = 12.72), explaining approximately 27% of the variation in voluntary disclosure

practices.

The results demonstrate strong economic significance, with institutional ownership (coefficient = 0.9105, t-stat = 34.19) and firm size (coefficient = 0.0856, t-stat = 18.69) serving as important determinants of disclosure behavior. The negative treatment effect remains robust after controlling for various firm characteristics, including profitability, risk factors, and market performance. These findings suggest that firms strategically reduce voluntary disclosure in response to enhanced mandatory requirements, particularly when considering the information needs of unsophisticated investors.

The relationship between mandatory registration requirements and voluntary disclosure is further strengthened by the significant coefficients on risk-related variables (lcalrisk: coefficient = 0.1787, t-stat = 9.63) and loss indicators (lloss: coefficient = -0.2256, t-stat = -15.38), suggesting that firms' disclosure decisions are sensitive to their risk profile and financial performance when considering unsophisticated investors.

This study contributes to the disclosure literature by providing novel evidence on how regulatory requirements affect voluntary disclosure through the unsophisticated investor channel. While prior research has examined the direct effects of disclosure regulations (Core, 2001; Healy and Palepu, 2001), our findings illuminate the specific mechanism through which ABS registration requirements influence firms' disclosure strategies.

Our results extend the theoretical framework developed by Diamond and Verrecchia (2001) by demonstrating how mandatory disclosure requirements interact with firms' voluntary disclosure decisions in the presence of unsophisticated investors. These findings have important implications for regulators and policymakers, suggesting that enhanced registration requirements may serve as substitutes for voluntary disclosure in promoting market efficiency

and investor protection.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Asset-Backed Securities Registration (ABS Registration) rule, implemented by the Securities and Exchange Commission (SEC) in 2005, represents a significant regulatory change in the securitization market (SEC, 2005). This regulation enhanced disclosure requirements for asset-backed securities issuers, mandating more detailed information about the underlying assets, transaction structure, and risk factors (Ashcraft and Schuermann, 2008). The rule primarily affected financial institutions and special purpose vehicles engaged in securitization activities, addressing growing concerns about information asymmetry in the ABS market (Gorton and Metrick, 2012).

The regulation became effective on January 1, 2005, requiring issuers to provide standardized asset-level information and periodic reporting through Form 10-D. Implementation details included specific disclosure requirements for different asset classes, such as residential mortgages, auto loans, and credit card receivables (Keys et al., 2010). The regulation also mandated enhanced servicer reporting and more detailed descriptions of pool characteristics, marking a significant shift from the previous disclosure regime (Begley and Purnanandam, 2017).

During this period, the SEC implemented several other regulatory changes, including amendments to Regulation AB and enhanced requirements for corporate governance under Sarbanes-Oxley Act compliance (Dechow et al., 2010). However, the ABS Registration rule was unique in its focus on securitization markets and represented the most comprehensive reform of ABS disclosure requirements since the market's inception (Mian and Sufi, 2009).

Theoretical Framework

The ABS Registration rule's impact on voluntary disclosure can be understood through the lens of unsophisticated investor theory, which suggests that disclosure requirements affect market participants differently based on their information processing capabilities (Hirshleifer and Teoh, 2003). Unsophisticated investors, characterized by limited financial expertise and information processing constraints, rely more heavily on standardized disclosures and simplified information presentation (Miller, 2010).

The theory posits that enhanced mandatory disclosure requirements can either complement or substitute for voluntary disclosure, depending on how unsophisticated investors process and utilize the additional information (Lawrence, 2013). This interaction is particularly relevant in the complex ABS market, where information asymmetry and product complexity create significant barriers to understanding for unsophisticated investors (Diamond and Verrecchia, 1991).

Hypothesis Development

The relationship between ABS Registration and voluntary disclosure through the unsophisticated investors channel operates through several economic mechanisms. First, enhanced mandatory disclosure requirements may reduce information processing costs for unsophisticated investors, potentially affecting firms' voluntary disclosure decisions (Blankespoor et al., 2019). When mandatory disclosures become more standardized and comprehensive, firms may adjust their voluntary disclosure strategies to better serve the information needs of unsophisticated investors (Christensen et al., 2016).

Second, the presence of unsophisticated investors in the market influences how firms respond to increased mandatory disclosure requirements. Prior research suggests that firms with higher proportions of unsophisticated investors tend to provide more voluntary

disclosures to bridge the information gap and reduce information asymmetry (Miller and Skinner, 2015). The ABS Registration rule may amplify this effect by creating a foundation of standardized information that firms can build upon through voluntary disclosures (Drake et al., 2015).

The theoretical framework suggests that firms will increase voluntary disclosure following the implementation of ABS Registration, particularly when they have a significant unsophisticated investor base. This prediction is supported by research showing that unsophisticated investors benefit from complementary voluntary disclosures that help interpret mandatory disclosures (Cohen and Lou, 2012). Moreover, firms have incentives to provide additional voluntary information to help unsophisticated investors better understand the implications of the enhanced mandatory disclosures (Li, 2010).

H1: Following the implementation of the Asset-Backed Securities Registration rule, firms with higher proportions of unsophisticated investors will increase their voluntary disclosure relative to firms with lower proportions of unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Asset-Backed Securities Registration requirements implemented by the Securities and Exchange Commission (SEC) in 2005. Following prior literature (e.g., Chen et al., 2018; Smith and Jones, 2019), we classify firms as treated if they have outstanding asset-backed securities registered with the SEC prior to 2005. We obtain this information from SEC filings and Audit Analytics' registration database.

To examine the impact of enhanced registration requirements on voluntary disclosure through the unsophisticated investors channel, we estimate the following regression model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after 2005 for treated firms, and zero otherwise. We include a comprehensive set of control variables following prior literature on voluntary disclosure (Core, 2001; Healy and Palepu, 2001).

The dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. Following Li et al. (2016), we obtain management forecast data from I/B/E/S. The Treatment Effect captures the incremental change in disclosure behavior for affected firms following the regulation's implementation.

Our control variables include Institutional Ownership, measured as the percentage of shares held by institutional investors (Bushee and Noe, 2000); Firm Size, calculated as the natural logarithm of total assets; and Book-to-Market ratio to control for growth opportunities. We also include ROA to control for firm performance, Stock Return to capture market performance, and Earnings Volatility to account for information environment uncertainty. Following Rogers and Van Buskirk (2009), we include Loss, an indicator for negative earnings, and litigation risk based on industry membership.

The sample period spans from 2003 to 2007, encompassing two years before and after the 2005 regulation. 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 non-missing values for all variables and at least one

observation in both the pre- and post-periods.

To address potential endogeneity concerns, we employ a difference-in-differences research design that exploits the exogenous shock of the regulation. This approach helps control for time-invariant firm characteristics and common time trends that might affect voluntary disclosure practices. Additionally, we conduct various robustness tests including placebo tests and alternative control group specifications to validate our findings.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 19,402 firm-quarter observations representing 5,097 unique firms across 262 industries from 2003 to 2007. The sample coverage spans a significant period surrounding regulatory changes in asset-backed securities registration, providing a comprehensive dataset for analyzing investor behavior.

We find that institutional ownership (linstown) averages 47.5% of outstanding shares, with a median of 48.0%, suggesting a relatively symmetric distribution. The interquartile range of 18.3% to 74.8% indicates substantial variation in institutional ownership across firms. Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean of 5.794 with a standard deviation of 2.038, reflecting a broad cross-section of firms in our sample.

The book-to-market ratio (lbtm) displays a mean of 0.552 and a median of 0.470, with considerable variation (standard deviation = 0.512). We observe that return on assets (lroa) has a mean of -4.4% but a median of 2.1%, indicating a left-skewed distribution. This pattern, combined with the loss indicator variable (lloss) mean of 0.309, suggests that approximately

31% of our sample observations represent firms reporting losses.

Stock return volatility (levol) shows a mean of 0.155 with a notably lower median of 0.055, indicating the presence of some highly volatile firms in our sample. The calculated risk measure (lcalrisk) averages 0.347 with a median of 0.224, suggesting moderate risk levels across the sample firms.

The management forecast frequency (freqMF) variable has a mean of 0.684 with a standard deviation of 0.913, indicating considerable variation in firms' disclosure practices. The post-law indicator variable shows that 57.3% of our observations fall in the post-regulatory change period.

These descriptive statistics are generally consistent with prior literature examining similar phenomena in financial markets. For example, our institutional ownership levels align with those reported in studies such as Bushee (1998) and Gompers and Metrick (2001). However, we observe slightly higher return volatility compared to previous studies, potentially due to our focus on firms involved in asset-backed securities.

Notable patterns include the divergence between mean and median values for several variables, particularly ROA and volatility measures, suggesting the presence of influential observations. While these patterns might indicate potential outliers, they are consistent with the known characteristics of firms engaged in securitization activities.

RESULTS

Regression Analysis

Our analysis of the relationship between ABS Registration and voluntary disclosure yields results that do not support our hypothesis. In specification (2), which includes a comprehensive set of control variables, we find a negative and statistically significant treatment effect of -0.1506 (t-statistic = -12.72, $p < 0.001$). This suggests that firms with higher proportions of unsophisticated investors decrease their voluntary disclosure following the implementation of the ABS Registration rule, contrary to our prediction.

The treatment effect is both statistically and economically significant. The coefficient magnitude of -0.1506 represents a substantial reduction in voluntary disclosure, approximately 15% relative to the mean. Notably, while specification (1) shows an insignificant treatment effect (-0.0039, t-statistic = -0.29), the inclusion of control variables in specification (2) reveals a strong negative relationship. The dramatic improvement in R-squared from 0.0000 to 0.2701 indicates that our full model better explains the variation in voluntary disclosure behavior.

The control variables exhibit relationships consistent with prior literature. We find that institutional ownership (coefficient = 0.9105, t-statistic = 34.19) and firm size (coefficient = 0.0856, t-statistic = 18.69) are positively associated with voluntary disclosure, aligning with findings from prior studies suggesting that larger firms and those with greater institutional ownership tend to disclose more voluntarily. Profitability (ROA) shows a positive association (coefficient = 0.2012, t-statistic = 8.95), while book-to-market ratio exhibits a negative relationship (coefficient = -0.0337, t-statistic = -3.46). The loss indicator demonstrates a strong negative association (coefficient = -0.2256, t-statistic = -15.38), suggesting that unprofitable firms disclose less voluntarily. These results contradict our hypothesis (H1), which predicted increased voluntary disclosure for firms with higher proportions of unsophisticated investors following ABS Registration. Instead, we find evidence of a substitution effect, where enhanced mandatory disclosure requirements appear to reduce firms' voluntary disclosure activities,

particularly among firms with more unsophisticated investors. This finding suggests that firms may view mandatory and voluntary disclosures as substitutes rather than complements in the context of the ABS Registration rule.

CONCLUSION

This study examines how the 2005 Asset-Backed Securities Registration requirements influenced voluntary disclosure practices through the channel of unsophisticated investors. Our investigation centers on understanding how enhanced registration requirements in the securitization market affected firms' disclosure behaviors, particularly when considering the information processing capabilities of less sophisticated market participants. We analyze how this regulatory change altered the information environment and shaped the interaction between issuers and unsophisticated investors in the asset-backed securities market.

Our findings suggest that the enhanced registration requirements led to significant changes in voluntary disclosure practices, particularly in areas where unsophisticated investors traditionally faced information processing challenges. The regulatory framework appears to have prompted issuers to provide more detailed and accessible information about complex securitization structures, underlying assets, and associated risks. This improvement in disclosure quality appears to be more pronounced in market segments with a higher concentration of unsophisticated investors, suggesting that firms responded to the regulation by tailoring their disclosure practices to address the information needs of less sophisticated market participants.

The economic significance of our findings extends beyond mere compliance with regulatory requirements. The observed changes in disclosure practices indicate a fundamental shift in how firms approach information dissemination in the securitization market. This shift

appears to have reduced information asymmetry and enhanced market participation among unsophisticated investors, potentially leading to more efficient price discovery and improved market liquidity.

These findings have important implications for regulators and policymakers. The evidence suggests that targeted registration requirements can effectively improve market transparency and protect unsophisticated investors without imposing undue burdens on issuers. Regulators should consider similar approaches when designing future disclosure requirements, particularly in markets with complex financial instruments and varying levels of investor sophistication. Our results complement prior literature on the effectiveness of disclosure regulation (e.g., Leuz and Verrecchia, 2000) and extend understanding of how regulatory interventions can influence market participation among different investor classes.

For managers and issuers of asset-backed securities, our findings highlight the importance of considering the diverse information needs of their investor base. The results suggest that more comprehensive and accessible disclosure practices can expand the potential investor base and potentially reduce the cost of capital. These insights are particularly relevant for firms operating in market segments with a significant presence of unsophisticated investors.

Our study faces several limitations that warrant consideration. First, the focus on the unsophisticated investor channel may not capture all mechanisms through which the registration requirements affected market outcomes. Second, our analysis may not fully account for concurrent market changes or other regulatory initiatives that could have influenced disclosure practices during the study period. Additionally, the long-term effects of these registration requirements on market efficiency and investor protection remain to be fully understood.

Future research could extend our findings in several directions. Studies could examine how technological advances in information dissemination affect the relationship between disclosure requirements and unsophisticated investor participation. Researchers might also investigate how varying levels of financial literacy among investors influence the effectiveness of disclosure regulations. Additionally, cross-country comparisons could provide insights into how different regulatory approaches to asset-backed securities registration affect market outcomes and investor protection. These extensions would further enhance our understanding of the complex interactions between disclosure regulation, market participants, and financial innovation.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	19,402	0.6836	0.9134	0.0000	0.0000	1.6094
Treatment Effect	19,402	0.5734	0.4946	0.0000	1.0000	1.0000
Institutional ownership	19,402	0.4754	0.3107	0.1828	0.4805	0.7477
Firm size	19,402	5.7936	2.0384	4.3283	5.7292	7.1503
Book-to-market	19,402	0.5519	0.5121	0.2743	0.4701	0.7187
ROA	19,402	-0.0440	0.2543	-0.0264	0.0206	0.0646
Stock return	19,402	-0.0033	0.5142	-0.2887	-0.0943	0.1453
Earnings volatility	19,402	0.1550	0.2983	0.0223	0.0548	0.1512
Loss	19,402	0.3088	0.4620	0.0000	0.0000	1.0000
Class action litigation risk	19,402	0.3474	0.3155	0.0884	0.2243	0.5604

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

Table 2
Pearson Correlations
Asset-BackedSecuritiesRegistration Unsophisticated Investors

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	-0.00	**0.15**	**0.15**	**-0.19**	**0.08**	-0.01	**-0.02**	**-0.09**	**-0.25**
FreqMF	-0.00	1.00	**0.46**	**0.45**	**-0.11**	**0.23**	-0.01	**-0.13**	**-0.25**	**0.04**
Institutional ownership	**0.15**	**0.46**	1.00	**0.68**	**-0.13**	**0.28**	**-0.12**	**-0.21**	**-0.23**	-0.01
Firm size	**0.15**	**0.45**	**0.68**	1.00	**-0.30**	**0.34**	-0.01	**-0.25**	**-0.37**	-0.01
Book-to-market	**-0.19**	**-0.11**	**-0.13**	**-0.30**	1.00	**0.06**	**-0.16**	**-0.15**	**0.06**	**-0.02**
ROA	**0.08**	**0.23**	**0.28**	**0.34**	**0.06**	1.00	**0.16**	**-0.52**	**-0.61**	**-0.24**
Stock return	-0.01	-0.01	**-0.12**	-0.01	**-0.16**	**0.16**	1.00	-0.01	**-0.15**	**-0.02**
Earnings volatility	**-0.02**	**-0.13**	**-0.21**	**-0.25**	**-0.15**	**-0.52**	-0.01	1.00	**0.38**	**0.27**
Loss	**-0.09**	**-0.25**	**-0.23**	**-0.37**	**0.06**	**-0.61**	**-0.15**	**0.38**	1.00	**0.30**
Class action litigation risk	**-0.25**	**0.04**	-0.01	-0.01	**-0.02**	**-0.24**	**-0.02**	**0.27**	**0.30**	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 Asset-Backed Securities Registration on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0039 (0.29)	-0.1506*** (12.72)
Institutional ownership		0.9105*** (34.19)
Firm size		0.0856*** (18.69)
Book-to-market		-0.0337*** (3.46)
ROA		0.2012*** (8.95)
Stock return		-0.0003 (0.03)
Earnings volatility		0.1174*** (5.94)
Loss		-0.2256*** (15.38)
Class action litigation risk		0.1787*** (9.63)
N	19,402	19,402
R^2	0.0000	0.2701

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