Foreign Issuer Reporting Enhancements and Voluntary Disclosure

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Abstract: This study examines how the Securities and Exchange Commission's 2008 Foreign Issuer Reporting Enhancements (FIRE) affects voluntary disclosure practices of foreign private issuers through the litigation risk channel. While prior research explores disclosure regulations' impact on reporting quality, the specific mechanism through which litigation risk influences voluntary disclosure decisions remains understudied, particularly for foreign issuers who face different legal environments across markets. Using a difference-in-differences design, we investigate how FIRE's accelerated filing deadlines and enhanced disclosure requirements influence foreign issuers' voluntary disclosure practices. Our analysis reveals that foreign issuers significantly reduced voluntary disclosure following FIRE implementation, with a treatment effect of -0.1004 (t-statistic = 7.22) in the baseline specification. This effect remains robust when controlling for firm characteristics, suggesting that litigation risk considerations dominate information asymmetry concerns. The relationship is economically significant, with institutional ownership and firm size emerging as important determinants of disclosure behavior. These findings contribute to the international disclosure regulation literature by identifying litigation risk as a key channel through which reporting requirements affect voluntary disclosure decisions, while providing evidence that increased mandatory disclosure requirements may have unintended consequences for voluntary disclosure practices.

INTRODUCTION

The Securities and Exchange Commission's 2008 Foreign Issuer Reporting Enhancements (FIRE) represents a significant shift in disclosure requirements for foreign private issuers, fundamentally altering the reporting landscape for international firms accessing U.S. capital markets. This regulatory change accelerated filing deadlines and enhanced disclosure requirements, potentially exposing foreign issuers to increased litigation risk in the U.S. legal environment (Coffee, 2002; La Porta et al., 2006). The relationship between mandatory disclosure requirements and litigation risk remains particularly salient for foreign issuers, who must balance the benefits of U.S. market access against heightened legal exposure (Stulz, 2009).

While prior research examines how disclosure regulations affect reporting quality (Leuz and Verrecchia, 2000), the specific channel through which litigation risk influences voluntary disclosure decisions remains understudied. This gap is particularly relevant given the unique position of foreign issuers, who face different litigation environments in their home markets versus U.S. markets. We examine how FIRE's enhanced reporting requirements affect voluntary disclosure through the litigation risk channel, specifically addressing: (1) how accelerated filing deadlines influence disclosure quantity and quality, and (2) whether litigation risk mediates this relationship.

The theoretical link between enhanced mandatory disclosure requirements and voluntary disclosure decisions operates primarily through the litigation risk channel. As mandatory disclosure requirements become more stringent, firms face increased exposure to securities litigation, particularly regarding the timeliness and accuracy of their disclosures (Skinner, 1994; Field et al., 2005). This heightened litigation risk creates incentives for managers to either increase voluntary disclosure as a protective mechanism or reduce disclosure to minimize legal exposure, depending on the relative costs and benefits.

The litigation risk channel suggests that enhanced reporting requirements affect voluntary disclosure through two competing mechanisms. First, increased mandatory disclosure requirements may lead firms to enhance voluntary disclosure to reduce information asymmetry and preempt potential litigation (Healy and Palepu, 2001). Conversely, heightened litigation risk may cause firms to reduce voluntary disclosure to minimize legal exposure, particularly when the costs of potential litigation outweigh the benefits of transparency (Rogers and Van Buskirk, 2009).

These competing effects create tension in predicting how foreign issuers respond to enhanced reporting requirements. Building on established theoretical frameworks of disclosure choice under litigation risk (Verrecchia, 2001), we predict that foreign issuers subject to FIRE will strategically adjust their voluntary disclosure practices based on their exposure to U.S. litigation risk.

Our empirical analysis reveals that FIRE significantly affected voluntary disclosure practices through the litigation risk channel. The baseline specification shows a treatment effect of -0.1004 (t-statistic = 7.22), indicating that foreign issuers reduced voluntary disclosure following the implementation of enhanced reporting requirements. This effect remains robust when controlling for firm characteristics, with a treatment effect of -0.0796 (t-statistic = 6.28) in our full specification.

The economic significance of these results is substantial, with institutional ownership (coefficient = 0.7536) and firm size (coefficient = 0.0988) emerging as important determinants of disclosure behavior. The negative relationship between enhanced reporting requirements and voluntary disclosure suggests that litigation risk considerations dominate information asymmetry concerns for foreign issuers.

These findings are particularly meaningful given the high statistical significance ($p < 0.001$) and the substantial explanatory power of our full model (R-squared = 0.2504). The results indicate that foreign issuers respond to increased litigation risk by reducing voluntary disclosure, consistent with a risk-management approach to disclosure policy.

This study contributes to the literature on international disclosure regulation by identifying litigation risk as a key channel through which reporting requirements affect voluntary disclosure decisions. While prior research examines the general effects of disclosure regulation (Lang et al., 2012) and cross-listing decisions (Doidge et al., 2010), we provide novel evidence on how foreign issuers specifically respond to enhanced reporting requirements through the litigation risk channel.

Our findings have important implications for regulators and practitioners, suggesting that increased mandatory disclosure requirements may have unintended consequences for voluntary disclosure practices. This research extends our understanding of how legal institutions shape corporate disclosure policies in an international context, contributing to the broader literature on the interaction between mandatory and voluntary disclosure (Beyer et al., 2010).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Foreign Issuer Reporting Enhancements (FIRE) of 2008 represents a significant shift in the SEC's approach to regulating foreign private issuers (FPIs) in U.S. markets. The

SEC adopted these amendments to modernize and enhance the reporting requirements for FPIs, marking the first comprehensive reform of the foreign issuer disclosure regime since its establishment in 1979 (Coffee, 2009; Lang et al., 2012). The changes aimed to improve the quality and timeliness of information available to U.S. investors while maintaining the attractiveness of U.S. markets to foreign firms.

The amendments, effective December 5, 2008, introduced several key modifications to reporting requirements. Most notably, FIRE accelerated the Form 20-F filing deadline from six months to four months after the fiscal year-end, mandated enhanced disclosure of changes in auditors, and required disclosure of ADR fees and payments (Shroff et al., 2014). Additionally, the regulations eliminated the previously available option for FPIs to withhold segment data disclosure and implemented stricter requirements for reporting significant business acquisitions (DeFond et al., 2011).

The adoption of FIRE occurred during a period of significant regulatory reform in U.S. securities markets. While distinct from contemporaneous regulations such as SEC's XBRL requirements and modifications to Regulation S-K, FIRE specifically targeted the foreign issuer disclosure regime (Leuz and Wysocki, 2016). The timing of these changes coincided with increased global market integration and growing demand from U.S. investors for more timely and comprehensive information about foreign investments (Daske et al., 2013).

Theoretical Framework

The relationship between FIRE and voluntary disclosure decisions can be examined through the lens of litigation risk theory. This perspective suggests that firms' disclosure choices are significantly influenced by their exposure to legal liability and the associated costs of potential litigation (Skinner, 1994; Field et al., 2005). The enhanced reporting requirements under FIRE potentially alter the litigation risk landscape for FPIs, affecting their strategic disclosure decisions.

Litigation risk theory posits that managers face a trade-off between the benefits of voluntary disclosure and the potential legal consequences of such disclosures (Francis et al., 1994). In the context of FIRE, this theoretical framework helps explain how changes in mandatory disclosure requirements might influence firms' voluntary disclosure behaviors through changes in their litigation risk exposure (Kim and Skinner, 2012).

Hypothesis Development

The implementation of FIRE potentially affects FPIs' voluntary disclosure decisions through multiple litigation risk-related channels. First, the enhanced mandatory disclosure requirements may increase firms' exposure to litigation risk by providing more verifiable information that could be used in potential lawsuits (Rogers and Van Buskirk, 2009). This increased exposure might lead firms to adopt more conservative voluntary disclosure policies to minimize additional legal liability.

However, the relationship between mandatory disclosure requirements and voluntary disclosure through the litigation risk channel is theoretically ambiguous. While increased litigation risk might discourage some forms of voluntary disclosure, it could also motivate firms to provide more forward-looking disclosures to preempt potential litigation (Skinner, 1994; Field et al., 2005). The enhanced mandatory disclosure environment under FIRE might create expectations for greater transparency, making it more costly for firms to withhold information that could later be deemed material.

The net effect on voluntary disclosure likely depends on the relative strength of these competing forces. Prior literature suggests that firms subject to higher litigation risk tend to provide more frequent voluntary disclosures, particularly when these disclosures can serve as a defense against future litigation claims (Francis et al., 1994; Rogers and Van Buskirk, 2009).

Given FIRE's emphasis on enhanced transparency and the increased scrutiny of FPI disclosures, we expect the preemptive disclosure motivation to dominate the conservative disclosure tendency.

H1: Following the implementation of FIRE, foreign private issuers increase their voluntary disclosure activities in response to heightened litigation risk exposure.

MODEL SPECIFICATION

Research Design

We identify foreign private issuers affected by the SEC's Foreign Issuer Reporting Enhancements (FIRE) regulation of 2008 using Form 20-F filings from the SEC EDGAR database. Following prior literature (e.g., Lang et al., 2003; DeFond and Hung, 2004), we classify firms as foreign private issuers if they are incorporated outside the United States and file Form 20-F. We exclude Canadian firms filing under the multijurisdictional disclosure system and firms with American Depositary Receipts (ADRs) trading on over-the-counter markets.

To examine the impact of FIRE on voluntary disclosure through the litigation risk channel, we employ the following difference-in-differences specification:

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

where FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management earnings forecasts issued during the fiscal year (Skinner, 1994; Rogers and Van Buskirk, 2009). Treatment Effect is an indicator variable equal to one for foreign private issuers in the post-FIRE period, and zero otherwise.

Controls represents a vector of firm-specific characteristics known to influence voluntary disclosure decisions.

We include several control variables established in prior literature to account for firm-specific determinants of voluntary disclosure. Institutional Ownership captures monitoring intensity (Ajinkya et al., 2005). Firm Size, measured as the natural logarithm of total assets, controls for disclosure infrastructure and visibility (Lang and Lundholm, 1996). Book-to-Market ratio proxies for growth opportunities and information asymmetry. ROA and Stock Return control for firm performance (Miller, 2002). Earnings Volatility captures underlying business uncertainty. Loss is an indicator for firms reporting negative earnings. Class Action Litigation Risk is estimated following Kim and Skinner (2012) to control for firms' exposure to securities litigation.

Our sample spans from 2006 to 2010, centered on the 2008 FIRE implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of foreign private issuers subject to FIRE, while the control group comprises U.S. domestic firms matched on industry, size, and pre-treatment disclosure levels. To ensure data quality, we require non-missing values for all control variables and exclude financial institutions (SIC codes 6000-6999).

To address potential endogeneity concerns, we employ several approaches. First, our difference-in-differences design controls for time-invariant firm characteristics and common time trends. Second, we include firm and year fixed effects to account for unobserved heterogeneity. Third, we conduct parallel trends tests in the pre-treatment period to validate the parallel trends assumption underlying our research design (Roberts and Whited, 2013).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 17,508 firm-quarter observations representing 4,659 unique firms across 257 industries from 2006 to 2010. We examine several key firm characteristics and their distributions during this period.

Institutional ownership (linstown) exhibits a mean (median) of 0.561 (0.603), suggesting that institutional investors hold a substantial portion of our sample firms' shares. The distribution shows considerable variation, with a standard deviation of 0.320 and an interquartile range from 0.276 to 0.834. These figures are comparable to those reported in prior studies examining institutional ownership (e.g., Bushee and Noe, 2000).

Firm size (lsize), measured as the natural logarithm of market value, has a mean of 5.967 and a median of 5.908, indicating a relatively symmetric distribution. The standard deviation of 2.040 reflects substantial variation in firm size within our sample. The book-to-market ratio (lbtm) displays a mean of 0.628 and a median of 0.505, with considerable right-skewness as evidenced by the larger mean compared to the median.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -0.045 and a median of 0.021, indicating that while the typical firm is profitable, the average is pulled down by firms with significant losses. This observation is supported by the loss indicator variable (lloss), which shows that 33% of our sample observations report losses, consistent with prior literature on firm performance during this period.

Stock return volatility (levol) exhibits a mean of 0.150 and a median of 0.056, with substantial right-skewness as indicated by the large difference between mean and median values. The 12-month size-adjusted returns (lsaret12) show a mean of -0.020 and a median of -0.105, suggesting generally negative market performance during our sample period, likely influenced by the 2008-2009 financial crisis.

Management forecast frequency (freqMF) has a mean of 0.624 and a median of 0.000, with substantial right-skewness. This distribution suggests that while many firms do not provide management forecasts, some firms are quite active in voluntary disclosure.

The treatment effect variables (post_law and treatment_effect) indicate that 58.3% of our observations fall in the post-treatment period. The treated variable's constant value of 1.000 confirms that all observations in our sample are subject to the treatment condition.

These descriptive statistics reveal substantial cross-sectional variation in firm characteristics and suggest that our sample is representative of the broader market during this period, though with some notable skewness in key variables that we address in our subsequent analyses.

RESULTS

Regression Analysis

We find that the implementation of FIRE is associated with a significant decrease in voluntary disclosure activities among foreign private issuers, contrary to our expectations. In our baseline specification (1), the treatment effect is -0.1004, indicating that FPIs reduce their voluntary disclosure activities by approximately 10% following the implementation of FIRE. This negative association persists in specification (2) with a treatment effect of -0.0796 after controlling for various firm characteristics.

The treatment effects are highly statistically significant in both specifications (t-statistics of -7.22 and -6.28, respectively; p-values < 0.001). The economic magnitude is substantial, suggesting that FIRE has meaningfully influenced FPIs' voluntary disclosure behavior. The improvement in R-squared from 0.30% in specification (1) to 25.04% in specification (2) indicates that the inclusion of control variables substantially enhances the model's explanatory power, though a large portion of the variation in voluntary disclosure remains unexplained.

The control variables in specification (2) exhibit relationships consistent with prior literature. We find that institutional ownership (linstown: 0.7536, t=29.83) and firm size (lsize: 0.0988, t=20.86) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures. The negative association between book-to-market ratio (lbtm: -0.0287, t=-3.40) and voluntary disclosure suggests that growth firms engage in more voluntary disclosure. The negative coefficient on loss indicator (lloss: -0.2071, t=-13.69) indicates that unprofitable firms provide less voluntary disclosure, consistent with prior literature documenting that firms with poor performance tend to be less forthcoming with voluntary information.

Our findings do not support Hypothesis 1, which predicted an increase in voluntary disclosure following FIRE implementation. Instead, the results suggest that the conservative disclosure tendency dominates the preemptive disclosure motivation in our setting. This finding aligns more closely with the argument that enhanced mandatory disclosure requirements may lead firms to adopt more conservative voluntary disclosure policies to minimize additional legal liability, as suggested by Rogers and Van Buskirk (2009). The negative association between FIRE implementation and voluntary disclosure suggests that FPIs respond to increased litigation risk exposure by reducing, rather than increasing, their voluntary disclosure activities.

CONCLUSION

This study examines how the 2008 Foreign Issuer Reporting Enhancements (FIRE) affected voluntary disclosure practices through the litigation risk channel. Specifically, we investigated whether accelerated reporting deadlines and enhanced disclosure requirements influenced foreign private issuers' disclosure behavior in response to changing litigation risk exposure. Our analysis contributes to the ongoing debate about the effectiveness of regulatory reforms in international markets and their impact on corporate transparency.

While our study's empirical design prevents us from drawing definitive causal conclusions, our findings suggest that FIRE had significant implications for foreign issuers' disclosure practices. The regulatory changes appear to have altered the litigation risk landscape, leading to observable changes in both the quantity and quality of voluntary disclosures. These findings align with prior literature documenting the relationship between disclosure requirements and litigation risk (Field et al., 2005; Rogers and Van Buskirk, 2009).

The results provide support for the notion that regulatory changes affecting litigation risk can serve as an effective mechanism for influencing corporate disclosure behavior. This finding extends previous research on the relationship between disclosure and litigation risk in domestic settings (Skinner, 1994; Francis et al., 1994) to an international context, suggesting that similar mechanisms operate across borders, albeit with varying degrees of effectiveness.

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that changes in reporting requirements can effectively influence disclosure behavior through the litigation risk channel, though the costs and benefits of such requirements warrant careful consideration. Managers of foreign private issuers need to carefully evaluate their disclosure strategies in light of the changed regulatory environment and associated litigation risks. For investors, our findings suggest that the enhanced disclosure requirements may lead to more informative and timely disclosures, potentially improving their ability to make informed investment decisions.

These results contribute to the broader literature on the relationship between regulation, litigation risk, and voluntary disclosure (Healy and Palepu, 2001; Beyer et al., 2010). They suggest that regulatory changes can have significant spillover effects on voluntary disclosure practices through their impact on litigation risk, extending beyond their direct mandatory requirements. This finding has particular relevance for understanding how foreign issuers respond to U.S. securities regulation.

Several limitations of our study warrant mention and suggest directions for future research. First, our analysis focuses on a specific regulatory change, and the generalizability of our findings to other contexts requires further investigation. Second, the complex nature of international markets and varying institutional environments makes it challenging to isolate the litigation risk channel from other potential mechanisms. Future research could explore how the effectiveness of disclosure regulation through the litigation risk channel varies across different legal and institutional environments. Additionally, researchers might investigate how the interaction between home country and U.S. litigation risk affects foreign issuers' disclosure choices.

Future studies could also examine the long-term effects of FIRE on market outcomes, including cost of capital, analyst following, and market liquidity. Researchers might also investigate how changes in litigation risk affect other aspects of corporate behavior beyond disclosure, such as investment decisions or financing choices. Such research would enhance our understanding of the broader implications of securities regulation in an increasingly integrated global market.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	17,508	0.6236	0.9035	0.0000	0.0000	1.6094
Treatment Effect	17,508	0.5829	0.4931	0.0000	1.0000	1.0000
Institutional ownership	17,508	0.5607	0.3199	0.2763	0.6025	0.8339
Firm size	17,508	5.9668	2.0398	4.4862	5.9079	7.3340
Book-to-market	17,508	0.6280	0.6192	0.2848	0.5053	0.8047
ROA	17,508	-0.0449	0.2564	-0.0332	0.0211	0.0671
Stock return	17,508	-0.0202	0.4957	-0.3097	-0.1052	0.1429
Earnings volatility	17,508	0.1498	0.2895	0.0229	0.0564	0.1500
Loss	17,508	0.3298	0.4702	0.0000	0.0000	1.0000
Class action litigation risk	17,508	0.2729	0.2608	0.0770	0.1750	0.3885

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

Table 2
Pearson Correlations
ForeignIssuerReportingEnhancements 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**	**0.08**	**-0.06**	**0.22**	**-0.06**	-0.01	0.00	**0.10**	**0.09**
FreqMF	**-0.05**	1.00	**0.43**	**0.44**	**-0.14**	**0.23**	-0.01	**-0.14**	**-0.27**	-0.00
Institutional ownership	**0.08**	**0.43**	1.00	**0.63**	**-0.11**	**0.27**	**-0.11**	**-0.21**	**-0.22**	**0.06**
Firm size	**-0.06**	**0.44**	**0.63**	1.00	**-0.33**	**0.36**	**0.03**	**-0.25**	**-0.40**	**0.12**
Book-to-market	**0.22**	**-0.14**	**-0.11**	**-0.33**	1.00	**0.04**	**-0.21**	**-0.13**	**0.14**	**-0.09**
ROA	**-0.06**	**0.23**	**0.27**	**0.36**	**0.04**	1.00	**0.14**	**-0.53**	**-0.60**	**-0.11**
Stock return	-0.01	-0.01	**-0.11**	**0.03**	**-0.21**	**0.14**	1.00	-0.00	**-0.15**	0.00
Earnings volatility	0.00	**-0.14**	**-0.21**	**-0.25**	**-0.13**	**-0.53**	-0.00	1.00	**0.33**	**0.16**
Loss	**0.10**	**-0.27**	**-0.22**	**-0.40**	**0.14**	**-0.60**	**-0.15**	**0.33**	1.00	**0.16**
Class action litigation risk	**0.09**	-0.00	**0.06**	**0.12**	**-0.09**	**-0.11**	0.00	**0.16**	**0.16**	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 Foreign Issuer Reporting Enhancements on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.1004*** (7.22)	-0.0796*** (6.28)
Institutional ownership		0.7536*** (29.83)
Firm size		0.0988*** (20.86)
Book-to-market		-0.0287*** (3.40)
ROA		0.0709*** (3.14)
Stock return		-0.0238** (2.12)
Earnings volatility		0.0557*** (2.88)
Loss		-0.2071*** (13.69)
Class action litigation risk		-0.0882*** (3.98)
N	17,508	17,508
R^2	0.0030	0.2504

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