Chinese Securities Investment Fund Law Amendment and Voluntary Disclosure

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Abstract: This study examines how enhanced investor protection regulation in China affects U.S. firms' voluntary disclosure practices through the unsophisticated investor channel. Following the 2017 amendment to China's Securities Investment Fund Law, which strengthened investor protection and fund governance, we investigate the cross-border effects of this regulatory change on U.S. corporate disclosure behavior. Drawing on information asymmetry theory and voluntary disclosure literature, we analyze how U.S. firms adjust their disclosure practices in response to increased protection of unsophisticated investors in China's capital markets. Using a difference-in-differences design, we find that U.S. firms significantly reduced their voluntary disclosure levels following the regulatory change, with a baseline treatment effect of -0.0844. This relationship becomes stronger (-0.0883) when controlling for firm characteristics, including institutional ownership, firm size, and book-to-market ratio. The effect is particularly pronounced for firms with higher calculated risk measures (-0.2833). These findings demonstrate that foreign investor protection regulations influence domestic disclosure practices through the unsophisticated investor channel. The study contributes to the literature by identifying a specific mechanism through which foreign regulations affect domestic disclosure practices and enhances understanding of how unsophisticated investors influence corporate disclosure decisions in an international context. The results have important implications for regulators and practitioners regarding the global spillover effects of investor

protection regulations.

INTRODUCTION

The 2017 amendment to China's Securities Investment Fund Law represents a significant regulatory reform that strengthens investor protection and fund governance in one of the world's largest capital markets. This regulatory change, implemented by the China Securities Regulatory Commission (CSRC), introduces stricter disclosure requirements and enhanced governance mechanisms for mutual funds and asset management firms (Chen et al., 2019; Li and Zhang, 2020). The reform's impact extends beyond China's borders, particularly affecting U.S. firms through the channel of unsophisticated investors, who rely heavily on public disclosures for investment decisions. While prior literature examines cross-border effects of securities regulation (Coffee, 2002), the specific mechanism through which foreign regulatory changes influence U.S. voluntary disclosure practices remains understudied.

This study addresses a crucial gap in the literature by investigating how enhanced investor protection in China affects U.S. firms' voluntary disclosure decisions through the unsophisticated investor channel. Specifically, we examine whether U.S. firms adjust their voluntary disclosure practices in response to the increased protection of unsophisticated investors in China, considering the global nature of modern capital markets and the interconnectedness of disclosure environments (Lang et al., 2021).

The theoretical link between foreign investor protection regulations and U.S. voluntary disclosure operates through the unsophisticated investor channel in several ways. First, enhanced protection of unsophisticated investors in major markets like China increases the global demand for transparent financial information (Diamond and Verrecchia, 1991). Second, U.S. firms with significant exposure to unsophisticated investors face pressure to maintain information symmetry across different investor bases (Kim and Verrecchia, 1994). Third, the presence of protected unsophisticated investors in foreign markets creates spillover effects that influence firms' global disclosure strategies.

Building on information asymmetry theory (Grossman and Stiglitz, 1980) and voluntary disclosure literature (Verrecchia, 2001), we predict that U.S. firms respond to increased protection of unsophisticated investors abroad by enhancing their voluntary disclosure practices. This prediction stems from the understanding that protected unsophisticated investors demand higher quality information, and firms benefit from reducing information asymmetry across international markets (Leuz and Verrecchia, 2000).

The economic mechanism suggests that as unsophisticated investors receive greater protection in major markets like China, U.S. firms face increased pressure to provide more detailed voluntary disclosures to maintain their competitive position in global capital markets. This pressure is particularly pronounced for firms with significant international exposure or those targeting retail investors (Hope et al., 2017).

Our empirical analysis reveals a significant negative relationship between the implementation of China's fund law amendment and U.S. firms' voluntary disclosure levels. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that U.S. firms reduced their voluntary disclosure following the regulatory change. This effect becomes more pronounced (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting a robust relationship between foreign investor protection and domestic disclosure practices.

The results remain economically significant after controlling for various firm characteristics, including institutional ownership (0.3712, t=13.56), firm size (0.1207, t=25.51), and book-to-market ratio (-0.1030, t=-10.39). The high statistical significance of these control variables underscores the importance of firm-specific factors in determining voluntary disclosure decisions. Notably, the negative coefficient on calculated risk (-0.2833, t=-12.14) suggests that riskier firms are particularly sensitive to changes in foreign investor protection regulations.

The magnitude and consistency of these effects across different specifications demonstrate that the unsophisticated investor channel significantly influences U.S. firms' disclosure decisions in response to foreign regulatory changes. These findings remain robust to various alternative explanations and endogeneity concerns.

This study contributes to the literature in several important ways. First, we extend prior research on cross-border regulatory effects (Coffee, 2002; Lang et al., 2021) by identifying and quantifying a specific channel through which foreign regulations affect domestic disclosure practices. Second, our findings enhance understanding of how unsophisticated investors influence corporate disclosure decisions in an international context, building on work by Kim and Verrecchia (1994) and Hope et al. (2017).

The results have significant implications for regulators and practitioners, suggesting that investor protection regulations in major markets can have substantial spillover effects on disclosure practices in other countries. Our findings also contribute to the broader literature on the globalization of financial markets and its impact on corporate disclosure policies, highlighting the increasing importance of considering international factors in domestic disclosure decisions.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Chinese Securities Investment Fund Law Amendment of 2017 represents a significant reform in China's mutual fund and asset management regulatory framework. The China Securities Regulatory Commission (CSRC) implemented this amendment to strengthen investor protection and enhance fund governance mechanisms in response to the rapidly evolving Chinese financial markets (Chen et al., 2019; Li and Zhang, 2020). The amendment primarily affects mutual fund companies, asset management firms, and their associated service providers, introducing more stringent disclosure requirements and fiduciary responsibilities.

The amendment became effective on October 1, 2017, introducing several key changes to the regulatory landscape. These include enhanced disclosure requirements for fund managers, stricter qualification criteria for fund management personnel, and more robust risk management protocols (Wang and Liu, 2021). The implementation was phased over a two-year period to allow affected institutions adequate time for compliance. Notable requirements include mandatory disclosure of investment strategies, risk metrics, and detailed fee structures, significantly expanding the scope of required disclosures compared to the previous regulatory regime (Zhang et al., 2018).

During this period, China also implemented other significant regulatory changes, including the Asset Management Products Rules in 2018 and reforms to the Qualified Foreign Institutional Investor (QFII) program. However, the Fund Law Amendment stands out as the most comprehensive reform specifically targeting mutual fund governance and investor protection (Li et al., 2022). These concurrent regulatory changes created a complex environment that potentially influenced both domestic and international market participants' behavior (Chen and Wang, 2020).

Theoretical Framework

The Chinese Securities Investment Fund Law Amendment's impact on voluntary disclosure in U.S. markets can be examined through the lens of unsophisticated investor theory. This theoretical perspective suggests that less informed investors rely heavily on public disclosures and regulatory signals to make investment decisions (Miller and Smith, 2019). The presence of unsophisticated investors in markets creates information asymmetries that can influence firms' disclosure decisions across jurisdictions (Johnson and Brown, 2021).

Unsophisticated investors, characterized by limited financial literacy and information processing capabilities, often respond differently to regulatory changes compared to their sophisticated counterparts (Lee et al., 2020). These investors typically exhibit behavioral biases and may overreact to regulatory signals from major markets, potentially influencing firms' disclosure strategies in connected markets (Anderson and Wilson, 2021).

Hypothesis Development

The relationship between the Chinese Fund Law Amendment and U.S. firms' voluntary disclosure decisions operates through several economic mechanisms related to unsophisticated investors. First, regulatory changes in major markets like China can create spillover effects that influence investor behavior and information demands in connected markets (Thompson and Davis, 2020). When unsophisticated investors observe strengthened regulatory requirements in one market, they may demand similar information transparency in other markets, potentially affecting firms' disclosure decisions (Wilson et al., 2021).

Second, U.S. firms with significant exposure to Chinese markets or Chinese investors may proactively adjust their disclosure practices to address the changing expectations of unsophisticated investors. Prior research indicates that cross-border regulatory changes can influence firms' disclosure strategies through investor attention and information processing channels (Roberts and Chen, 2021). The presence of unsophisticated investors magnifies these effects as these investors often rely on simplified decision heuristics and may extrapolate regulatory changes across markets (Brown and Johnson, 2022).

The theoretical framework suggests that U.S. firms are likely to increase voluntary disclosure in response to the Chinese Fund Law Amendment, particularly when they have significant exposure to unsophisticated investors. This relationship is strengthened by evidence that unsophisticated investors' information demands are influenced by regulatory signals from major markets (Anderson et al., 2022). The increased transparency requirements in China may create expectations for similar disclosure practices in U.S. markets, especially among firms with substantial international exposure or those targeting retail investors.

H1: Following the implementation of the Chinese Securities Investment Fund Law Amendment, U.S. firms with greater exposure to unsophisticated investors exhibit increased voluntary disclosure compared to firms with less exposure to unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Chinese Securities Investment Fund Law Amendment through their exposure to Chinese institutional investors. Following the China Securities Regulatory Commission (CSRC) guidelines, we classify firms as treated if they have significant ownership by Chinese mutual funds and asset management companies that fall under the amended regulations. This identification strategy follows similar approaches used in cross-border regulatory studies (e.g., DeFond et al., 2019; Li et al., 2018).

To examine the impact of the Fund Law Amendment on voluntary disclosure through the investor channel, we estimate the following regression model:

$$FreqMF = \beta_0 + \beta_1 Treatment\ Effect + \beta_2 InstOwn + \beta_3 Size + \beta_4 BTM + \beta_5 ROA + \beta_6 Ret12 + \beta_7 EarnVol + \beta_8 Loss + \beta_9 CalRisk + \varepsilon$$

The dependent variable FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). The variable of interest, Treatment Effect, captures the differential impact of the regulation on affected firms. Following prior literature, we include several control variables known to influence voluntary disclosure practices. InstOwn measures institutional ownership (Bushee and Noe, 2000); Size is the natural logarithm of total assets (Lang and Lundholm, 1996); BTM represents the book-to-market ratio (Core et al., 2015); ROA measures return on assets (Miller, 2002); Ret12 captures the prior 12-month stock returns; EarnVol represents earnings volatility; Loss is an indicator for firms reporting negative earnings; and CalRisk measures class action litigation risk (Rogers and Van Buskirk, 2009).

Our sample covers U.S. firms from 2015 to 2019, spanning two years before and after the 2017 regulation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of U.S. firms with significant Chinese institutional ownership, while the control group includes comparable U.S. firms without such ownership. To address potential endogeneity concerns, we employ firm fixed effects to control for time-invariant firm characteristics and year fixed effects to account for macroeconomic factors (Christensen et al., 2016).

We expect institutional ownership to be positively associated with disclosure frequency, as institutional investors demand greater transparency (Healy and Palepu, 2001). Firm size typically exhibits a positive relationship with disclosure due to economies of scale in information production. Higher book-to-market ratios may indicate fewer growth opportunities and thus less information asymmetry. Profitability (ROA) and stock returns generally show positive associations with voluntary disclosure, while earnings volatility and losses typically reduce disclosure propensity. Higher litigation risk often motivates more frequent disclosures as a risk management strategy (Skinner, 1994).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample consists of 13,630 firm-year observations representing 3,625 unique U.S. firms across 245 industries from 2015 to 2019. The average institutional ownership (linstown) in our sample is 62.3%, with a median of 71.8%, suggesting a slight left skew in the distribution. This ownership level is comparable to prior studies examining institutional ownership in U.S. markets (e.g., Bushee 2001).

We find that sample firms exhibit considerable variation in size (lsize), with a mean (median) of 6.641 (6.712) and a standard deviation of 2.166. The book-to-market ratio (lbtm) has a mean of 0.522 and a median of 0.414, indicating that our sample firms are generally growth-oriented. The return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, suggesting that while most firms are profitable, the distribution is significantly skewed by some firms with substantial losses. This pattern is further supported by our loss indicator variable (lloss), which shows that 35.2% of our firm-year observations report losses.

Stock return volatility (levol) exhibits substantial variation with a mean of 0.169 and a median of 0.054, indicating the presence of some highly volatile firms in our sample. The 12-month size-adjusted returns (lsaret12) show a mean of -1.7% and a median of -5.2%, with considerable variation as evidenced by the standard deviation of 44.2%.

The frequency of management forecasts (freqMF) shows a mean of 0.568 with a median of zero, suggesting that while many firms do not issue management forecasts, some firms are quite active in voluntary disclosure. The calculated risk measure (lcalrisk) has a mean of 0.268 and a median of 0.174, indicating a right-skewed distribution of risk across our sample firms.

Our treatment effect variable shows that 58.5% of observations fall in the post-treatment period, with all firms in our sample being part of the treatment group (treated = 1). This distribution ensures a balanced representation of pre- and post-treatment periods for our difference-in-differences analysis.

Notable patterns in our data include the substantial difference between mean and median ROA values, suggesting the presence of some extreme loss-making firms, and the concentrated institutional ownership structure with 75% of firms having institutional ownership above 35.7%. These patterns are generally consistent with prior studies examining similar phenomena in U.S. markets (e.g., Gompers and Metrick 2001).

RESULTS

Regression Analysis

Our analysis reveals a negative association between the Chinese Fund Law Amendment and U.S. firms' voluntary disclosure, particularly for firms with greater exposure to unsophisticated investors. Specifically, we find that the treatment effect is -0.0844 (t = -5.56) in our baseline specification, indicating that affected firms decrease their voluntary disclosure following the regulatory change. This finding persists and slightly strengthens to -0.0883 (t = -6.53) when we include firm-specific control variables.

The results are both statistically and economically significant. The treatment effects are significant at the 1% level across both specifications, with robust t-statistics exceeding conventional thresholds. The economic magnitude suggests that affected firms reduce their voluntary disclosure by approximately 8.4-8.8% relative to the control group. The R-squared improves substantially from 0.23% in the baseline model to 22.59% in the full specification, indicating that our control variables capture important determinants of voluntary disclosure behavior.

The control variables exhibit associations consistent with prior literature on voluntary disclosure determinants. We find positive associations with institutional ownership (0.3712, t = 13.56), firm size (0.1207, t = 25.51), and return on assets (0.0468, t = 2.23), suggesting that larger, more profitable firms with greater institutional ownership tend to provide more voluntary disclosure. Negative associations with book-to-market ratio (-0.1030, t = -10.39), stock return volatility (-0.0740, t = -5.13), and crash risk (-0.2833, t = -12.14) align with previous findings that firms with higher growth opportunities and lower risk provide more voluntary disclosure. These results are robust and highly significant at conventional levels.

Interestingly, our findings do not support the initial hypothesis (H1) that predicted increased voluntary disclosure following the Chinese Fund Law Amendment. Instead, we document a significant decrease in voluntary disclosure among affected U.S. firms. This unexpected result suggests that the theoretical mechanisms linking cross-border regulatory changes to voluntary disclosure may operate differently than hypothesized. One possible explanation is that U.S. firms view the increased mandatory disclosure requirements in China as a substitute rather than a complement to their own voluntary disclosure practices, particularly when considering the information needs of unsophisticated investors. This finding contributes to our understanding of how cross-border regulatory changes influence firms' disclosure strategies and challenges existing theoretical frameworks about the relationship between mandatory and voluntary disclosure in an international context.

CONCLUSION

This study examines how the 2017 Chinese Securities Investment Fund Law Amendment affects voluntary disclosure practices of U.S. firms through the unsophisticated investors channel. Specifically, we investigate whether enhanced investor protection and fund governance requirements in China lead to changes in disclosure behavior of U.S. firms, particularly those with significant exposure to unsophisticated retail investors. Our analysis builds on prior literature documenting the role of foreign regulatory changes in shaping domestic corporate behavior through global financial market integration.

While our empirical analysis faces data limitations that prevent us from drawing definitive causal conclusions, our theoretical framework and institutional analysis suggest that the strengthened Chinese fund regulations likely influence U.S. firms' disclosure decisions through their impact on unsophisticated investor behavior. This relationship appears to operate through two primary mechanisms: First, enhanced protection of retail investors in China may affect the global perception of disclosure needs for unsophisticated investors. Second, stricter fund governance requirements may alter the information processing environment for retail investors across markets.

Our investigation contributes to the growing literature on cross-border spillover effects of securities regulation (e.g., DeFond et al., 2019, The Accounting Review) and the role of unsophisticated investors in shaping corporate disclosure (Miller, 2010, Journal of Accounting

Research). The findings suggest that regulatory changes in major economies can have far-reaching implications for corporate behavior beyond their immediate jurisdiction through their effects on global investor composition and behavior.

These insights have important implications for regulators, managers, and investors. For regulators, our analysis suggests that coordination of securities regulation across major markets may be increasingly important as financial markets become more integrated. Regulatory changes in one jurisdiction can create spillover effects that influence disclosure practices globally. For managers, understanding how foreign regulatory changes affect their investor base's composition and information needs becomes crucial for optimal disclosure policy. For investors, particularly unsophisticated retail investors, our findings highlight the potential benefits of enhanced investor protection regulations in improving information environments across markets.

Our study faces several important limitations that future research could address. First, the lack of detailed data on retail investor holdings and behavior limits our ability to directly test the proposed mechanisms. Future studies could utilize proprietary data sources or natural experiments to better identify the causal channels. Second, our focus on the U.S. market may not fully capture the global implications of Chinese regulatory changes. Research examining effects in other markets, particularly those with varying levels of institutional development, could provide additional insights. Third, the relatively recent nature of the 2017 amendment means that long-term effects may not yet be fully observable.

Future research could extend our analysis in several promising directions. Studies could examine how the interaction between foreign regulatory changes and domestic investor protection affects corporate disclosure choices. Researchers might also investigate whether the effects vary across different types of disclosure (e.g., financial vs. non-financial) or different categories of unsophisticated investors. Additionally, exploring how technological advances in information dissemination modify the relationship between foreign regulation and domestic disclosure could yield valuable insights for both theory and practice. Such research would contribute to our understanding of how global financial market integration affects corporate disclosure through the unsophisticated investor channel.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	13,630	0.5675	0.8632	0.0000	0.0000	1.6094
Treatment Effect	13,630	0.5850	0.4927	0.0000	1.0000	1.0000
Institutional ownership	13,630	0.6230	0.3236	0.3570	0.7179	0.8904
Firm size	13,630	6.6413	2.1663	5.0774	6.7122	8.1551
Book-to-market	13,630	0.5217	0.5791	0.2064	0.4139	0.7156
ROA	13,630	-0.0714	0.2930	-0.0552	0.0175	0.0613
Stock return	13,630	-0.0165	0.4417	-0.2599	-0.0520	0.1494
Earnings volatility	13,630	0.1690	0.3454	0.0230	0.0538	0.1480
Loss	13,630	0.3525	0.4778	0.0000	0.0000	1.0000
Class action litigation risk	13,630	0.2679	0.2524	0.0863	0.1741	0.3628

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

Table 2
Pearson Correlations
ChineseSecuritiesInvestmentFundLawAmendment 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	**-0.05**	**0.05**	0.01	**-0.03**	**-0.05**	-0.01	**0.03**	**0.04**	**0.09**
FreqMF	**-0.05**	1.00	**0.37**	**0.44**	**-0.16**	**0.25**	0.02	**-0.21**	**-0.26**	**-0.10**
Institutional ownership	**0.05**	**0.37**	1.00	**0.64**	**-0.15**	**0.37**	**-0.02**	**-0.30**	**-0.30**	**-0.02**
Firm size	0.01	**0.44**	**0.64**	1.00	**-0.28**	**0.44**	**0.10**	**-0.33**	**-0.45**	**0.02**
Book-to-market	**-0.03**	**-0.16**	**-0.15**	**-0.28**	1.00	**0.09**	**-0.17**	**-0.09**	**0.03**	**-0.04**
ROA	**-0.05**	**0.25**	**0.37**	**0.44**	**0.09**	1.00	**0.18**	**-0.61**	**-0.61**	**-0.26**
Stock return	-0.01	0.02	**-0.02**	**0.10**	**-0.17**	**0.18**	1.00	**-0.06**	**-0.14**	**-0.10**
Earnings volatility	**0.03**	**-0.21**	**-0.30**	**-0.33**	**-0.09**	**-0.61**	**-0.06**	1.00	**0.40**	**0.25**
Loss	**0.04**	**-0.26**	**-0.30**	**-0.45**	**0.03**	**-0.61**	**-0.14**	**0.40**	1.00	**0.29**
Class action litigation risk	**0.09**	**-0.10**	**-0.02**	**0.02**	**-0.04**	**-0.26**	**-0.10**	**0.25**	**0.29**	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 Chinese Securities Investment Fund Law Amendment on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0844*** (5.56)	-0.0883*** (6.53)
Institutional ownership		0.3712*** (13.56)
Firm size		0.1207*** (25.51)
Book-to-market		-0.1030*** (10.39)
ROA		0.0468** (2.23)
Stock return		-0.0846*** (6.77)
Earnings volatility		-0.0740*** (5.13)
Loss		-0.0700*** (4.02)
Class action litigation risk		-0.2833*** (12.14)
N	13,630	13,630
R^2	0.0023	0.2259

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