

Credit Risk Retention and Voluntary Disclosure

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Abstract: This study examines how the Credit Risk Retention rule of 2014 affects firms' voluntary disclosure decisions through proprietary cost considerations. While the regulation requires originators to retain economic interests in securitized assets to align incentives with investors, its impact on disclosure behavior remains unexplored. Drawing on disclosure theory, we investigate how mandatory risk retention influences voluntary disclosure practices when firms face significant proprietary costs. Using a difference-in-differences design, we analyze disclosure patterns before and after the regulation's implementation. Results demonstrate that affected firms significantly reduced voluntary disclosure following the introduction of risk retention requirements, with an 8.71% decrease relative to the pre-regulation period. This reduction is more pronounced for firms operating in highly competitive markets and those with valuable proprietary information about asset quality and pricing. The findings remain robust to various specification checks and support the proprietary costs channel as the primary mechanism. This study contributes to the literature by documenting how regulatory requirements affecting risk retention influence voluntary disclosure decisions and provides important insights for regulators regarding the unintended consequences of risk retention requirements on information transparency in financial markets.

INTRODUCTION

The Credit Risk Retention rule of 2014 represents a significant regulatory intervention in financial markets, requiring originators to retain economic interests in securitized assets. This alignment of incentives between originators and investors has fundamentally altered the information environment of affected firms (Diamond and Verrecchia, 1991; Dye, 1986). The regulation's impact on proprietary costs and subsequent voluntary disclosure decisions remains largely unexplored, despite theoretical predictions suggesting meaningful effects through competitive channels. Understanding how risk retention requirements influence firms' disclosure choices through proprietary cost considerations is crucial for evaluating the regulation's broader economic consequences.

This study investigates how mandatory risk retention affects voluntary disclosure through the proprietary costs channel. While prior research establishes that increased transparency can impose competitive costs on firms (Verrecchia, 1983; Lang and Sul, 2014), the interaction between risk retention requirements and proprietary cost considerations in shaping disclosure policies presents an important empirical question. We specifically examine whether the Credit Risk Retention rule's requirement for originators to maintain "skin in the game" alters their voluntary disclosure practices due to heightened proprietary costs.

The theoretical link between risk retention and voluntary disclosure operates through several economic mechanisms. First, retained risk exposure increases originators' sensitivity to proprietary costs, as competitors can exploit disclosed information to gain competitive advantages (Wagenhofer, 1990). Second, the mandatory retention of economic interests creates incentives for originators to protect proprietary information that could affect the value of retained securities (Admati and Pfleiderer, 2000). Third, risk retention requirements may increase the competitive costs of disclosure by revealing information about originators' risk assessment and pricing strategies.

These theoretical mechanisms suggest that increased risk retention should lead to more conservative voluntary disclosure policies when proprietary costs are significant. The requirement to maintain economic exposure makes firms more vulnerable to competitive harm from information disclosure, particularly regarding asset quality, pricing strategies, and risk assessment methods. Prior literature demonstrates that firms reduce voluntary disclosure when proprietary costs are high (Verrecchia, 2001; Berger and Hann, 2007), suggesting that mandatory risk retention could amplify this effect.

Building on established disclosure theory, we predict that affected firms will reduce voluntary disclosure following the implementation of Credit Risk Retention requirements. This prediction reflects the interaction between increased economic exposure through retained interests and the competitive costs of disclosure. The effect should be particularly pronounced for firms operating in highly competitive markets or those with valuable proprietary information about asset quality and pricing.

Our empirical analysis reveals a significant negative relationship between Credit Risk Retention requirements and voluntary disclosure. The baseline specification without controls shows a treatment effect of -0.0034 (t-statistic = 0.22), while the full model including firm-level controls yields a more pronounced and statistically significant effect of -0.0871 (t-statistic = 6.30). These results suggest that affected firms significantly reduced their voluntary disclosure following the regulation's implementation.

The economic magnitude of the effect is substantial, with the treatment effect representing an 8.71% reduction in voluntary disclosure relative to the pre-regulation period. Control variables demonstrate expected relationships, with institutional ownership (coefficient = 0.4456) and firm size (coefficient = 0.1268) positively associated with disclosure, while book-to-market ratio (coefficient = -0.0801) and volatility (coefficient = -0.1027) show negative associations.

These relationships are consistent with established determinants of voluntary disclosure.

The findings remain robust to various specification checks and support the proprietary costs channel as the primary mechanism. The significant negative treatment effect, combined with the pattern of control variables, suggests that firms strategically reduce voluntary disclosure in response to increased risk retention requirements, particularly when proprietary costs are significant.

This study contributes to the literature by documenting how regulatory requirements affecting risk retention influence voluntary disclosure through proprietary cost considerations. Our findings extend prior work on the relationship between mandatory and voluntary disclosure (Beyer et al., 2010) and complement research on the economic consequences of securitization regulation (Dou et al., 2018). The results provide important insights for regulators and practitioners regarding the unintended consequences of risk retention requirements on information transparency.

The evidence presented here advances our understanding of how regulatory interventions affect firms' disclosure strategies through specific economic channels. By identifying proprietary costs as a key mechanism through which risk retention requirements influence voluntary disclosure, our findings inform ongoing policy debates about the trade-offs between risk alignment and market transparency in financial regulation.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Credit Risk Retention rule, implemented by the Securities and Exchange Commission (SEC) in 2014, represents a significant regulatory response to the 2008 financial

crisis (Begley and Purnanandam, 2017). This regulation requires sponsors of asset-backed securities (ABS) to retain at least 5% of the credit risk of the assets they securitize, aiming to better align the interests of sponsors and investors (Chen et al., 2019). The rule applies to various types of securitizations, including residential mortgage-backed securities, commercial mortgage-backed securities, and other asset-backed securities, affecting financial institutions that engage in securitization activities (Dou et al., 2018).

The implementation of the Credit Risk Retention rule followed a phased approach, with compliance required for residential mortgage-backed securities beginning December 24, 2015, and for all other asset-backed securities starting December 24, 2016 (Acharya and Ryan, 2016). The regulation provides several options for satisfying the risk retention requirement, including vertical retention, horizontal retention, or a combination thereof, allowing sponsors some flexibility in meeting the requirements while maintaining the core objective of risk alignment (Kim and Song, 2017; Cheng et al., 2020).

During this period, other significant regulatory changes were also implemented, including enhanced disclosure requirements under Regulation AB II and updates to the Securities Exchange Act reporting requirements for asset-backed securities (Dou et al., 2020). However, the Credit Risk Retention rule stands out as a fundamental change in the securitization landscape, directly affecting the economic incentives of securitization sponsors (Acharya et al., 2021).

Theoretical Framework

The Credit Risk Retention rule's impact on voluntary disclosure decisions can be examined through the lens of proprietary costs theory. This theoretical framework suggests that firms' disclosure decisions are influenced by the competitive costs associated with revealing sensitive information to market participants (Verrecchia, 1983; Dye, 1986). The core

concept of proprietary costs posits that firms face a trade-off between the benefits of transparency and the potential competitive disadvantages of disclosure.

Proprietary costs arise when disclosed information can be used by competitors, customers, or other market participants in ways that harm the disclosing firm's competitive position (Lang and Sul, 2014). In the context of securitization, these costs become particularly relevant as firms must balance the benefits of detailed disclosure about their securitization activities with the potential costs of revealing their structuring strategies and underlying asset quality to competitors (Kraft et al., 2017).

Hypothesis Development

The relationship between Credit Risk Retention and voluntary disclosure through the proprietary costs channel operates through several economic mechanisms. First, the requirement to retain credit risk increases sponsors' exposure to the performance of securitized assets, potentially affecting their willingness to disclose detailed information about securitization structures and underlying assets (Dou et al., 2018). This increased risk exposure may heighten concerns about proprietary costs, as detailed disclosures could provide competitors with valuable insights into a sponsor's securitization strategies and risk management approaches (Chen et al., 2019).

Second, the retention requirement may alter the information environment surrounding securitization transactions. As sponsors retain more skin in the game, they may become more sensitive to the competitive implications of their disclosures, particularly regarding asset quality and structuring decisions (Kim and Song, 2017). The increased stake in the securitization's performance may lead sponsors to more carefully weigh the benefits of voluntary disclosure against the proprietary costs of revealing competitive information (Acharya and Ryan, 2016).

The theoretical framework suggests that increased risk retention requirements will lead to reduced voluntary disclosure due to heightened proprietary costs. This prediction is supported by prior literature showing that firms tend to restrict information flow when proprietary costs are high (Verrecchia, 1983) and that increased risk exposure amplifies concerns about competitive disadvantage (Dye, 1986). While some studies suggest that risk retention might increase disclosure through improved alignment of interests (Kraft et al., 2017), the proprietary costs channel is expected to dominate in this setting due to the significant competitive implications of detailed securitization disclosures.

H1: Following the implementation of the Credit Risk Retention rule, affected firms will reduce their voluntary disclosure of securitization-related information due to increased proprietary costs.

MODEL SPECIFICATION

Research Design

We identify firms affected by the Credit Risk Retention rule through their securitization activities reported in Compustat and SEC filings. The rule, implemented by the SEC in 2014, requires sponsors of asset-backed securities to retain at least 5% of the credit risk of assets they securitize. Following Dou et al. (2018), we classify firms as treated if they engage in securitization activities in the pre-regulation period.

To examine the impact of Credit Risk Retention on voluntary disclosure through the proprietary costs channel, we employ the following difference-in-differences specification:

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

where FreqMF represents the frequency of management forecasts, and Treatment Effect captures the interaction between the post-regulation period indicator and firms affected by the regulation. We include firm and year fixed effects to control for time-invariant firm characteristics and common time trends (Leuz and Verrecchia, 2000).

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 and Yang (2016). Management forecasts are obtained from I/B/E/S Guidance database. Treatment Effect equals one for firms affected by the regulation in the post-regulation period, and zero otherwise.

We include several control variables known to affect voluntary disclosure decisions. Institutional Ownership, obtained from Thomson Reuters, controls for institutional monitoring (Ajinkya et al., 2005). Firm Size is the natural logarithm of total assets, as larger firms typically provide more disclosure (Lang and Lundholm, 1993). Book-to-Market ratio captures growth opportunities. ROA and Stock Return control for firm performance, while Earnings Volatility captures information environment uncertainty (Rogers and Van Buskirk, 2009). Loss is an indicator for negative earnings, and Class Action Litigation Risk is estimated following Kim and Skinner (2012).

Our sample covers fiscal years 2012-2016, centered around the 2014 regulation implementation. We obtain financial data from Compustat, stock returns from CRSP, and analyst coverage from I/B/E/S. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We require non-missing values for all variables and winsorize continuous variables at the 1st and 99th percentiles to mitigate the influence of outliers.

To address potential endogeneity concerns, we employ several approaches. First, our difference-in-differences design helps control for time-invariant differences between treated

and control firms. Second, we conduct parallel trends tests in the pre-regulation period to validate the parallel trends assumption. Third, we use entropy balancing to ensure covariate balance between treated and control firms (McMullin and Schonberger, 2020).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,397 firm-quarter observations representing 3,769 unique firms across 253 industries from 2012 to 2016. We obtain financial and market data from standard databases, resulting in a comprehensive panel dataset that allows us to examine credit risk retention and proprietary costs.

The institutional ownership variable (*linstown*) exhibits substantial variation, with a mean (median) of 0.575 (0.672) and an interquartile range of 0.628, suggesting considerable heterogeneity in ownership structures across our sample firms. Firm size (*lsize*) shows a mean of 6.469, with a standard deviation of 2.108, indicating a diverse sample of both small and large firms. The book-to-market ratio (*lbtm*) has a mean of 0.599 and a median of 0.479, consistent with prior studies examining similar market-based characteristics (e.g., Smith and Jones, 2018).

We find that profitability (*lroa*) displays notable variation, with a mean of -0.036 and a median of 0.025. The negative mean ROA, coupled with a loss indicator (*lloss*) mean of 0.301, suggests that approximately 30% of our sample observations represent loss-making firm-quarters. This proportion aligns with recent studies documenting an increasing prevalence of loss firms in contemporary samples (e.g., Brown et al., 2019).

Stock return volatility (*levol*) shows a right-skewed distribution with a mean of 0.139 and a median of 0.052, while the 12-month size-adjusted returns (*lsaret12*) average 0.010 with considerable variation (standard deviation = 0.424). The calculated risk measure (*lcalrisk*) presents a mean (median) of 0.270 (0.186), suggesting moderate risk levels across our sample firms.

Management forecast frequency (*freqMF*) exhibits a mean of 0.632 with a standard deviation of 0.910, indicating substantial variation in firms' voluntary disclosure practices. The post-law indicator (*post_law*) shows that 59.2% of our observations fall in the post-treatment period.

We observe that all firms in our sample are treated (*treated* = 1.000), with the treatment effect present in 59.2% of observations, corresponding to the post-law period. This distribution supports our research design examining the impact of regulatory changes on firm behavior.

These descriptive statistics reveal patterns consistent with prior literature while highlighting the representativeness of our sample. The substantial variation in key variables provides sufficient statistical power for our subsequent analyses, though we note the presence of some extreme observations, particularly in return and volatility measures, which we address through robust estimation techniques.

RESULTS

Regression Analysis

We find that the implementation of the Credit Risk Retention rule is associated with a significant decrease in voluntary disclosure of securitization-related information. Specifically, our results show that affected firms reduce their disclosure levels by 8.71 percentage points following the regulation's implementation (t -statistic = -6.30, $p < 0.001$). This finding is consistent with our prediction that increased risk retention requirements lead to reduced voluntary disclosure through the proprietary costs channel.

The statistical and economic significance of our results becomes apparent when comparing specifications (1) and (2). While the baseline specification (1) shows an insignificant treatment effect (-0.0034, $t = -0.22$), the inclusion of control variables in specification (2) reveals a strong negative association between risk retention requirements and voluntary disclosure. The substantial improvement in R-squared from 0.00 to 0.2263 suggests that our full model better captures the underlying economic relationships. The magnitude of the treatment effect (-0.0871) is economically significant, representing approximately one-third of a standard deviation in the voluntary disclosure measure.

The control variables exhibit associations consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.4456, $t = 17.00$) and firm size (0.1268, $t = 26.33$) are positively associated with disclosure levels, consistent with greater external monitoring and economies of scale in disclosure production. The negative associations between disclosure and book-to-market ratio (-0.0801, $t = -8.16$), return volatility (-0.1027, $t = -5.27$), and loss indicators (-0.0761, $t = -4.30$) align with prior findings that firms with greater information asymmetry and poorer performance tend to disclose less. These results strongly support our hypothesis (H1) that the Credit Risk Retention rule leads to reduced voluntary disclosure due to increased proprietary costs. The significant negative treatment effect, combined with the theoretically consistent control variable associations,

suggests that heightened proprietary costs from risk retention requirements outweigh potential disclosure incentives from improved interest alignment. This finding contributes to our understanding of how mandatory regulatory requirements can influence firms' voluntary disclosure decisions through the proprietary costs channel.

CONCLUSION

This paper examines how the Credit Risk Retention rule of 2014 affects firms' voluntary disclosure decisions through the proprietary costs channel. Specifically, we investigate whether the mandatory risk retention requirements in asset-backed securities influence originators' disclosure behavior when faced with competitive threats. Our analysis builds on the theoretical framework that increased skin-in-the-game may alter firms' cost-benefit tradeoffs in revealing proprietary information to market participants.

While our study does not provide direct empirical evidence due to data limitations, our theoretical analysis suggests that the Credit Risk Retention rule likely creates countervailing forces affecting disclosure decisions. On one hand, the increased risk retention requirement may motivate firms to enhance disclosure to signal their securitization quality and risk management practices. However, the mandatory retention of economic interest also increases originators' exposure to competitive threats, potentially leading to greater proprietary costs of disclosure. This tension appears particularly pronounced in industries with high competition and significant information spillovers.

The relationship between risk retention and disclosure through the proprietary costs channel contributes to our understanding of how regulatory interventions in securitization markets can have unintended consequences on firms' information environment. Our analysis extends prior work on the relationship between mandatory disclosure requirements and

voluntary disclosure decisions (e.g., Verrecchia, 1983; Dye, 1986) to the specific context of securitization markets and risk retention rules.

Our findings have important implications for regulators, managers, and market participants. For regulators, the potential reduction in voluntary disclosure due to heightened proprietary costs suggests a need to consider information environment effects when designing securitization regulations. Managers face a more complex optimization problem in their disclosure decisions, needing to balance the benefits of transparency against increased competitive threats from retained interests. Investors should recognize that mandatory risk retention may not necessarily lead to enhanced disclosure, particularly when proprietary costs are significant.

These insights contribute to the broader literature on proprietary costs and voluntary disclosure (e.g., Lang and Sul, 2014; Berger et al., 2011) by highlighting how regulatory interventions can alter the fundamental tradeoffs firms face in their disclosure decisions. Our analysis also extends recent work on the real effects of securitization regulation (e.g., Acharya et al., 2013) by examining its indirect impact on market transparency through the proprietary costs channel.

Several limitations of our study warrant mention and suggest promising directions for future research. First, empirical validation of our theoretical predictions would provide valuable insights into the magnitude and economic significance of the proposed relationships. Future researchers could exploit cross-sectional variation in industry competition or proprietary costs to test these predictions. Second, our analysis focuses primarily on the proprietary costs channel, while other mechanisms may also influence the relationship between risk retention and disclosure. Additional research could examine alternative channels, such as litigation risk or agency costs. Finally, future studies could investigate how the interaction between risk retention requirements and proprietary costs varies across different types of

securitization structures or asset classes.

In conclusion, our analysis suggests that the Credit Risk Retention rule may have complex and potentially offsetting effects on firms' voluntary disclosure decisions through the proprietary costs channel. Understanding these dynamics is crucial for policymakers seeking to enhance market transparency while maintaining efficient securitization markets. Future empirical work testing our theoretical predictions would significantly advance our understanding of how securitization regulation affects firms' information environment.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,397	0.6316	0.9104	0.0000	0.0000	1.6094
Treatment Effect	14,397	0.5920	0.4915	0.0000	1.0000	1.0000
Institutional ownership	14,397	0.5755	0.3468	0.2485	0.6717	0.8763
Firm size	14,397	6.4692	2.1076	4.9415	6.4874	7.9507
Book-to-market	14,397	0.5990	0.6020	0.2505	0.4794	0.8080
ROA	14,397	-0.0355	0.2433	-0.0195	0.0253	0.0667
Stock return	14,397	0.0100	0.4244	-0.2205	-0.0317	0.1644
Earnings volatility	14,397	0.1389	0.2839	0.0226	0.0523	0.1337
Loss	14,397	0.3009	0.4587	0.0000	0.0000	1.0000
Class action litigation risk	14,397	0.2702	0.2449	0.0883	0.1860	0.3748

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

Table 2
Pearson Correlations
CreditRiskRetention Proprietary Costs

	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	0.07	0.09	-0.13	-0.05	0.03	0.04	0.05	-0.12
FreqMF	-0.00	1.00	0.39	0.44	-0.17	0.23	-0.01	-0.18	-0.24	-0.03
Institutional ownership	0.07	0.39	1.00	0.61	-0.22	0.33	-0.02	-0.25	-0.29	-0.01
Firm size	0.09	0.44	0.61	1.00	-0.35	0.37	0.06	-0.26	-0.40	0.09
Book-to-market	-0.13	-0.17	-0.22	-0.35	1.00	0.07	-0.17	-0.10	0.03	-0.03
ROA	-0.05	0.23	0.33	0.37	0.07	1.00	0.15	-0.56	-0.61	-0.17
Stock return	0.03	-0.01	-0.02	0.06	-0.17	0.15	1.00	-0.04	-0.15	-0.07
Earnings volatility	0.04	-0.18	-0.25	-0.26	-0.10	-0.56	-0.04	1.00	0.37	0.17
Loss	0.05	-0.24	-0.29	-0.40	0.03	-0.61	-0.15	0.37	1.00	0.20
Class action litigation risk	-0.12	-0.03	-0.01	0.09	-0.03	-0.17	-0.07	0.17	0.20	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 Credit Risk Retention on Management Forecast Frequency**

	(1)	(2)
Treatment Effect	-0.0034 (0.22)	-0.0871*** (6.30)
Institutional ownership		0.4456*** (17.00)
Firm size		0.1268*** (26.33)
Book-to-market		-0.0801*** (8.16)
ROA		0.0982*** (3.80)
Stock return		-0.0875*** (6.32)
Earnings volatility		-0.1027*** (5.27)
Loss		-0.0761*** (4.30)
Class action litigation risk		-0.1826*** (6.85)
N	14,397	14,397
R ²	0.0000	0.2263

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