

Study Asserts Startling Numbers of Insider Trading Rogues

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OBJECTIVE:

This study was conducted to see if stocks and options move in unusual ways because word leaks out to select investors prior to the public release.

METHODS USED:

Hundreds of transactions from 1996 through the end of 2012 were analyzed. The three professors that conducted this study examined stock option movements — when an investor buys an option to acquire a stock in the future at a set price — as a way of determining whether unusual activity took place in the 30 days before a deal's announcement.

KEY FINDINGS:

- A quarter of all public company deals may involve some kind of insider trading.
- The Securities and Exchange Commission litigated only about 4.7 percent of the 1,859 M.&A. deals included in the sample.
- It takes the S.E.C., on average, 756 days to publicly announce its first litigation action and more than two years to prosecute a rogue trade.
- The average “rogue trade” was worth about \$1.6 million.
- The bigger the deal and the more trading volume in the stock of the target company, the more likely there will be insider trading.
- There weren't more leaks to investors based on the number of advisers — bankers and lawyers — involved in the deal.
- Completed deals are strong predictors of options litigation, as a withdrawn or rumored deal is about 22 times less likely to be investigated.

CONCLUSION:

- “The large number of investigations for stock trades relative to option trades stands in contrast to our finding of pervasive abnormal call option trading volumes that are relatively greater than the abnormal stock volumes.”
- Outside directors should be trained on corporate compliance and business ethics.
- The S.E.C. and the Justice Department have publicly made prosecuting insider trading a priority.

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