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Recent Study Reveals High Pervasiveness of Insider Trading
by Roxana Guidero, J.D. Candidate 2016

Insider trading happens. That statement probably comes as no surprise to most. News of traders such as Raj Rajaratnam and Rengan Rajaratnam show that insider trading occurs, is frequently prosecuted, and many inside traders face high penalties and even jail time for their illegal trades. But just how pervasive is the practice of insider trading? A recent study by two professors from the Stern School of Business at New York University and one professor from McGill University shows that insider trading actually occurs in a shockingly high number of transactions. According to the study, a quarter of all public company deals appear to involve some kind of insider trading.

The Methodology

The study looked at hundreds of transactions from 1996 through the end of 2012, focusing on stock option movements—where an investor purchases an option to buy stock in the future at a set price—in order to determine whether unusual activity occurred in the 30 days prior to a merger and acquisitions ("M&A") deal getting announced.

The Results

As mentioned, the study revealed that a quarter of all public company deals appear to involve some kind of insider trading. The study also revealed that "informed trading is more pervasive in cases of target firms receiving cash offers," reasoning that cash deals are more definitive as compared to stock deals which are "harder to bet on." Additionally, and perhaps shockingly, the study also showed that the number of illegal tips did not increase based on the number of bankers and lawyers involved in the deal (i.e., there was no correlation between the number of people possessing material inside information on a deal and the number of inside trades conducted).

What Do the Results Mean?

The results of the study are bad news for law enforcement. According to the study, the Securities and Exchange Commission ("SEC") only litigated about 4.7 percent of the 1,859 M&A transactions included in the study's sample. The pervasiveness of insider trading evidenced by the study compared to insider trading prosecutions by the SEC and the Justice Department ("DOJ") show that law enforcement is lagging behind and has a lot of catching up to do. This is hard to reconcile with the SEC and the DOJ's stated commitment to prosecuting insider trading. (For example, the SEC's website notes that "insider trading continues to be a high priority area for the SEC's enforcement program.") Based on recent insider trading prosecutions, such as Raj Rajaratnam's conviction and the investigation into Carl C. Icahn, it appears that the government's commitment to insider trading would be better stated as: insider trading continues to be a high priority *so long as prominent figures are involved.* In some ways this makes sense, because "the S.E.C., being resource-constrained, pursues larger-sized cases

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that provide the biggest 'bang for the buck' from a regulatory perspective." Furthermore, the study showed that the SEC's investigations focused on deals that were completed, missing trades conducted in relation to a deal that later collapsed. The SEC had no immediate comment on the results of the study.

For an overview of insider trading, see A Look at the Past, Present, and Expected Future of Insider Trading (PDF), also *available* here.