How much does an Illegal Insider Trade?

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Our research shows that the volume traded by insiders is positively linked to the value of their insider information and negatively related to the likely penalty they will receive if detected by market regulators. These findings suggest that individuals trade off the costs and benefits of crime. An important finding of our study is that the volume traded by insiders is influenced by the probability of detection which is affected by the underlying market structure, the characteristics of the stocks they trade, and the strategies employed by the insiders to counter detection.

Insider trading remains an important concern of regulators despite almost two decades of innovation in enforcement. A recent action brought against employees of several well-known Wall Street firms and hedge funds (*SEC v Guttenberg et al.* 2007) reveals that the scale of insider trading schemes remains unchanged since the 1980s.

Empirical academic research to date has focused on the effect of illegal insider trading on market behaviour, but little is known about the behaviour of illegal insiders. In this study we utilize a unique dataset made available by the Capital Market CRC, which is collected from the litigation reports made available via the U.S Securities and Exchange Commission. The dataset contains information about the investigation and action taken against a defendant of illegal insider trading, which allows us to identify the actual trades initiated by illegal insiders and hence examine the features associated with their behaviour.

An understanding of the factors that influence the volume traded by insiders is important to regulators. To this end, one contribution of our study is to show that insiders attempt to "hide in the crowd". This strategic behaviour questions the practice of regulators who tend to detect potential illegal insider trading by examining abnormal trading activities (Harris 2003, p. 588). The findings of our study can assist security regulators to design more rigorous and sophisticated detection methods in their on-going battle with illegal insider traders.

Capital Markets CRC has subsequent to this research designed and released a multi-jurisdiction data set containing (alleged, convicted and acquitted) market integrity matters brought before the courts. At present, the data-set contains over 4000 multi-jurisdictions sourced and coded against various jurisdictions (USA, Canada, Malaysia, UK, Australia, Singapore and Hong Kong) sources based on market, media, regulatory and court reports and releases. Matters range across the years 2000 to present, and cases continue to be coded as and when reported.

The database is intended to support research in the legal/capital markets domain, providing data driven insights across various categories of market misconduct (market manipulation, insider trading, continuous disclosure, deceptive and misleading misconduct, short selling). A benefit of having a single source of market misconduct violations across time periods may support enhancements to existing metrics/proxies for misconduct as well as development of new proxies factoring in survivorship/prosecution bias based on the characteristics (insights) gleamed from the legal and trade data making up the case.