Brokers 'tipping' clients prior to public release of analyst recommendations – CMCRC

15 July, 2013 (Sydney): A study conducted by Capital Markets Cooperative Research Centre (CMCRC), the Australian independent academic centre for capital market research, reveals abnormal trading volumes prior to public release of analyst recommendations on associated stocks, suggesting evidence of 'tipping' to privileged clients by some brokers.

The study was conducted by Professor Andrew Lepone, Dr. Jin Boon Wong and PhD candidate Ming Ying Lim. It examines broker trading volumes before and after analyst recommendations are made public. Data showed spikes in trading volume by recommending broker before the public release of the analyst reports.

This evidence suggests that analyst recommendations are possibly provided to broker clients via private release prior to the public release. CMCRC CEO, Professor Michael Aitken, said that while this behavior isn't illegal, it does offer an advantage to those 'in the know.'

"Our results document that after the private release of the information, trading activity increases most significantly for small and medium cap stocks," he said. "Since smaller stocks have less analyst coverage, it is likely that analyst recommendations in these stocks provide new information to the market which provides greater profit potential from 'tipping' activities. We also noted that a direct relationship exists between recommendation changes (from buy to sell or vice versa) and volume, as significant changes in trading volume eventuated from recommendation changes."

The research also examined the market impact costs of trades executed after the public release of recommendations, using intraday trade-by-trade data. Results show that recommending brokers experience similar market impact costs as their peers, providing an incentive to 'tip' clients to stay competitive for trading commissions. Interestingly, the introduction of broker anonymity in 2005 reduced market impact costs experienced by all brokers.

The paper did note that some brokers had implemented policies and procedures to avoid 'tipping' with analysts being dismissed for inappropriate behavior.

The research used publically available data that contains brokers ID for approximately 3,800 analyst recommendations on 338 ASX listed stocks.

For copies of the full study and interviews with Michael Aitken:

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About the authors:

Professor Mike Aitken is widely regarded as the most industry-centric academic associated with Australian capital markets. As the founder and former CEO of SIRCA (www.sirca.org.au), he has used his industry affiliations to build and share infrastructure which now underwrites the research activities of 50+ universities across Asia-Pacific.

Working through SMARTS Group (www.smartsgroup.com), he has designed the world's first "off-the-shelf" surveillance software now in use at 40 national exchanges and regulators (including NYSE-Euronext, Nasdaq-OMX, HK Exchanges, the Swiss Exchange, the Singapore Exchange and the Australian Securities Exchange) and 150 brokers across 40 countries.

He leads the research initiatives of the CMCRC which currently includes providing fully outsourced trading services to the securities industry as well as outsourced surveillance technology to the health and general insurance sectors.

Professor Andrew Lepone is a Professor of Finance at the Macquarie Graduate School of Management (commencing August 2013), and is Head of Partner Relations at the Capital Markets CRC Limited (CMCRC). He completed his Ph.D. at the University of Sydney in 2007. He is actively involved in research in the areas of equity and futures market microstructure, particularly related to the areas of market design and market quality. In particular, he has examined how particular market designs affect market quality, including the structure of off-market block trading facilities and the effect of minimum tick-size reductions for futures contracts. He has published numerous articles in leading internationally refereed journals, including the *Journal of Banking and Finance*, *Journal of Financial Markets* and the *Journal of Empirical Finance*.

Dr. Jin Boon Wong is post-doctorate at the Macquarie Graduate School of Management (MGSM). He has previously worked in the Singapore Exchange and the hedge fund industry.

Ming Ying Lim is a PhD candidate at MGSM.

About CMCRC:

The *Capital Markets Cooperative Research Centre* is a world-leading research organisation that provides thought leadership and break-through technology solutions for capital and health markets (www.cmcrc.com). It is funded equally by the Australian Government, an alliance of University partners and industry partners including regulators, exchanges and market participants across 10 countries. Research is funded from pooled funding and not sponsored by individuals, companies or institutions. To address its prime goal of industry relevance, industry partners have a major role in the research questions the CMCRC addresses. Academics have primary control over the research design and therefore the results.